Duke Law Journal

VOLUME 1985

FEBRUARY

NUMBER 1

CORPORATE WARS AND CHOICE OF LAW

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On the occasion of the increase in corporate wars and takeover battles, the author examines the constitutional and conflict of laws issues involved in choosing the law to govern the internal affairs aspects of the defensive and offensive strategies and tactics used in the various confrontations. This leads to a review of recent judicial and legislative developments, including the antitakeover statutes, to an examination of the traditional and the new conflict-of-laws methodologies as they affect internal corporate affairs, and to an analysis of the implications of the due process, full faith and credit, and, especially, the commerce clauses of the United States Constitution. Finally, the extraterritoriality of the internal affairs dimension of federal securities regulation and the imposition of controls over multinational enterprises are explored.

TABLE OF CONTENTS

I. INTRODUCTION	3
II. CORPORATE WARS AND INTERNAL CORPORATE AFFAIRS	4
III. THE DIFFERENCES IN STATE CORPORATE LAW AND THE IMPORTANCE OF CHOICE	9
IV. THE CONTINUING PREVALENCE OF THE LAW OF THE STATE OF INCORPORATION FOR DETERMINING INTERNAL CORPORATE AFFAIRS: THE MINIMAL IMPACT OF THE CONFLICTS REVOLUTION	15
A. <i>Judicial Practice</i>	15
1. <i>The Traditional Rule</i>	15
2. <i>The Implications of the Conflicts Revolution</i>	16

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3. <i>The Actual Impact of the Conflicts Revolution Upon Choice of Law for Internal Corporate Affairs</i>	17
a. <i>Takeover battles</i>	18
b. <i>Termination of derivative suits</i>	19
c. <i>Other aspects of derivative suits</i>	21
d. <i>Freezeouts and squeezeouts</i>	23
e. <i>Other issues</i>	24
B. <i>Statutory Support for the Rule of Lex Incorporationis</i>	26
V. THE CONSTITUTIONAL UNDERPINNINGS OF THE LEX INCORPORATIONIS: FROM FULL FAITH AND CREDIT TO THE COMMERCE CLAUSE	30
A. <i>Choice of Law and the Constitution</i>	30
B. <i>Choice of Law for Corporate Internal Affairs Under Full Faith and Credit and Due Process</i>	33
C. <i>The Conflicts Implications of Edgar v. MITE Corp. and of the Revitalized Commerce Clause</i>	35
VI. ALTERNATIVES TO OR DEVIATIONS FROM THE LEX INCORPORATIONIS: CONFLICTS ANALYSIS WITHIN THE CONSTITUTIONAL FRAMEWORK	46
A. <i>The New Conflicts, the Lex Incorporationis and the "Real Seat" Rule</i>	46
B. <i>Viable Alternatives to the Lex Incorporationis</i>	55
1. <i>The Pseudo-Foreign Corporation: Update and Reevaluation</i>	55
a. <i>The Latty proposals and the principle of the Mansfield case</i>	55
b. <i>The status of the California regulation of the internal affairs of California-centered corporations</i>	57
2. <i>Mandating "Domestication" or Local Incorporation for Intrastate Operations</i>	61
C. <i>Deviations from the Lex Incorporationis to Protect Important Local Interests</i>	63
1. <i>The Different Categories of Internal Affairs and Local Corporate Policy</i>	63
2. <i>Limited Interventions in New York and California</i>	66
D. <i>The Lex Incorporationis and the Metamorphosis of State Takeover Legislation</i>	76
1. <i>The Commerce Clause Problem</i>	76
a. <i>Ohio regulation of "control share acquisitions"</i>	76

b. <i>The Maryland controls over second-tier transactions</i>	79
c. <i>The Pennsylvania extension</i>	80
d. <i>The Minnesota-Wisconsin dare: reaching take-overs of foreign corporations under the umbrella of blue-sky regulation</i>	82
2. <i>The Preemption Issue</i>	85
VII. THE INTERNATIONAL DIMENSIONS OF THE LEX INCORPORATIONIS: FEDERAL SECURITIES LAWS	86
A. <i>The Explicit Controls Under the Securities and Exchange Act of 1934 and the SEC Rules</i>	87
B. <i>The Impact on Internal Affairs of the Extraterritoriality of Section 10(b) and Rule 10(b)(5)</i> .	90
C. <i>The Multinational Corporation and the Lex Incorporationis</i>	93
VIII. CONCLUSION	96

I. INTRODUCTION

Corporations are legal "persons" endowed with rights and subject to obligations, much like human beings. Although the law applicable to most relationships among persons is unaffected by the nature of the participants, because corporations are man-made their composition, structure, organs, functions, and constituencies are addressed by substantive and procedural rules of a special kind, codified in statutes and enshrined and amplified in corporate documents. Not only are these rules more numerous and complex than those in other fields of law, but they are strongly interrelated because they control a multifaceted and continuous relationship rather than just a transaction or a series of transactions. The choice of a single or at least congruent body of law to regulate that internal relationship is therefore of great importance.

Under the traditional Anglo-American conflicts rule, internal corporate affairs are governed by the law of the state of incorporation—the "lex incorporationis." European nations apply the law of the designated corporate seat, which often coincides with that of the state of incorporation. Both of these rules essentially enable the corporate organizers to select the applicable law at will, in disregard of the realities of corporate existence and operations. Continental concern over the potential abuses of such autonomy has led to the qualification that the selected law applies only if the location of the seat is "real." In the United States, critics of the lex incorporationis have strived to create an exception for "pseudo-foreign" corporations, and legislation in New York and California calls

for the application of a considerable portion of domestic corporation law to foreign corporations having major local contacts.

The tension between the policies, on the one hand, that validate party autonomy and recognize the practical utility of certainty, uniformity, and continuity served by the traditional rules, and, on the other, the need to prevent evasion of the regulatory authority of the state or states with substantial corporate contacts, has assumed new significance in the context of the increasingly frequent wars for corporate control, such as proxy fights and takeovers. Furthermore, the expansion of international and multinational corporate activities raises again the question of whether it would be proper for host states to seek to achieve local objectives by internalizing controls of foreign corporations.

This article first assesses the present status of the *lex incorporationis* in the United States while adding some information on developments in Europe.¹ It then explores the actual and potential alternatives and exceptions to the rule, taking into consideration the "conflicts revolution" of the last twenty years.² It is here that I will examine the new antitakeover statutes and inquire into the scope of application of legislation intended to protect shareholders by limiting or controlling management's antitakeover abuses.³ Finally, the article will focus on the international ramifications of corporate choice-of-law questions, with particular emphasis on the so-called "extraterritoriality" of the internal affairs aspects of federal securities law and on the internal regulation of the multinational corporation.⁴

II. THE CORPORATE WARS

Corporate battles have intensified in recent years. Although in such struggles internal power is frequently consolidated through negotiation, it all too often results from confrontations pitching giants against titans in tender offers, proxy contests, and buy-outs. Corporate law is so flexible that lawyers have been able to invent and perfect an incredible variety of intricate devices designed to advance the goals of their clients.

Anticipatory defenses include "shark repellents" such as supermajority voting provisions for corporate consolidations and share-

1. See *infra* notes 24-41 and accompanying text. It has been over a quarter of a century since the last comprehensive publication in the United States on this subject. See Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118 (1958). The most recent major critique dates back to 1968. See Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433 (1968).

2. See *infra* notes 211-391 and accompanying text.

3. See *infra* notes 392-442 and accompanying text.

4. See *infra* notes 443-93 and accompanying text.

holder or director consent requirements for controlling stock acquisitions, elimination or installation of cumulative voting and of classified boards, fair-pricing requirements for second-step consolidations or mandatory-bid provisions, "poison pill" or "flip-over" preferred stock or warrants or rights that are triggered by stock accumulations, "golden parachutes"—long-term high-pay employment contracts—for corporate executives, reduction of voting rights of large shareholdings, tightening of provisions on the convocation and agenda of shareholder meetings, and setting up complex structures involving holding companies or other affiliations.⁵ The 1984 proxy materials of more than 200 corporations included proposals that erect barriers to unwanted changes of control; most of these were adopted.⁶

When battle is joined, it is not uncommon to resort to such tactics as disposal of "crown jewels" or "poisoning the well" or other "scorched earth" action, defensive acquisitions that generate antitrust problems, submission to "greenmail," lock-ups or leg-ups to "white knights" on

5. For a "glossary" of these and related colorful terms, see SEC Advisory Committee on Tender Offers, *Report of Recommendations*, FED. SEC. L. REP. (CCH) ¶¶ 140-141, No. 1028 (Extra Edition, July 15, 1983) [hereinafter cited as *Report*]. The report also provides general information on tender offer developments in recent years. For additional information on offensive and defensive tactics in tender offers as well as on nomenclature, see, e.g., E. ARANOW, H. EINHORN & G. BERLSTEIN, *DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL* 193-99 (1977); A. FLEISCHER, *TENDER OFFERS: DEFENSES, RESPONSES AND PLANNING* 291-396 (1983); M. LIPTON & E. STEINBERGER, *TAKEOVERS AND FREEZEOUTS* §§ 51.01-.07 (1984); R. WINTER, M. STUMPF & G. HAWKINS, *SHARK REPELLENTS AND GOLDEN PARACHUTES: A HANDBOOK FOR THE PRACTITIONER* §§ 2.1-.8 (1984); DeMott, *Pac-Man Tender Offers*, 1983 DUKE L.J. 116, 129-32; Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1165-74 (1981); Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L.J. 291, 291-96 (1984); Fleischer & Raymond, *Lockups Ease Acquisitions, May Forestall Bidding War*, Legal Times, Oct. 24, 1983, at 13, col. 1; Frennd & Volk, *Tender Offers: Developments on Offense*, 11 INST. ON SEC. REG. 1, 2-6 (1980); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 848-62 (1981); Lang, Block, Barton & Duberstein, *The Dramatization of a Hostile Tender Offer*, 70 A.B.A. J. 68, 68-73 (1984); Lipton, *Takeover Bids in the Target's Boardroom: An Update After One Year*, 36 BUS. LAW. 1017, 1017-22 (1981); Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 130-31 (1979); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 249-59 (1983); Nathan & Volk, *Developments in Acquisition and Acquisition Techniques Under the Williams Act*, 12 INST. ON SEC. REG. 159, 188-90 (1981); Note, *Lock-Up Options: Toward a State Law Standard*, 96 HARV. L. REV. 1068, 1069-74 (1983); Note, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U. L. REV. 621, 621-24, 658-60 (1983); Note, *Golden Parachutes: Executive Employment Contracts*, 40 WASH. & LEE L. REV. 1117, 1117-25 (1983); Note, *Developments in Corporate Takeover Techniques: Creeping Tender Offers, Lockup Arrangements, and Standstill Agreements*, 39 WASH. & LEE L. REV. 1095, 1095-99, 1116-19 (1982); *Exotic Takeover Tactics Dominate Discussion at Annual PLI Institute*, 16 SEC. REG. & L. REP. (BNA) No. 44, at 1751-55 (Nov. 9, 1984).

6. See "Large and Mighty" Companies Erect Control Change Barriers, *Report Says*, 16 SEC. REG. & L. REP. (BNA) No. 40, at 1634 (Oct. 12, 1984); see also Vartanian & Ledig, *Thrifty Institutions Adopting More Shark Repellents*, Legal Times, Oct. 1, 1984, at 12, col. 1.

assets or stock, armistices or alliances under "standstill" agreements, and, if all else fails, competitive tender offers for the target corporation's own stock or "pac man" or doomsday-machine counter-tender offers for enemy stock.⁷

These are monumental developments. The separation between ownership and control, noted some years ago and discussed at length in various think-pieces,⁸ reduces the shareholder to a passive investor and enables management all too often to dominate and self-perpetuate. This separation is greatly reinforced by newly installed "protective" provisions and structures that, allegedly in the interests of the corporation and the shareholders themselves, not only discourage any challenge by the shareholders but often adversely affect their opportunities as investors to profit by selling their stock.⁹ In the proverbial race-to-the-bottom environment of state enabling legislation, strengthened now by the pressure of local management, there is only faint hope for legislative action to curtail—through redefinition of the business judgment rule or otherwise—the most obviously abusive self-serving practices of management. In the same spirit, a substantial majority of the states in the 1970's enacted "first generation" blue-sky type controls that went beyond the disclosures mandated by federal law and tipped the scale in favor of incumbent management. Many of these statutes extended to the out-of-state component of tender offers and applied even to shares of foreign corporations. When the Supreme Court recently held such extraterritoriality inconsistent with the commerce clause,¹⁰ some states abandoned the blue-sky route and instituted or authorized internal affairs controls, mostly for domestic corporations, aimed again at the hostile takeover wherever it takes place.¹¹ This movement is gaining strength and its constitutionality is being tested in the courts, with a final decision likely to be rendered eventually by the Supreme Court.¹²

Two major decisions of the Supreme Court have reduced the role of federal securities law in this field. In a landmark 1977 ruling the Court held that corporate breaches of fiduciary duty not involving deception do

7. For definitions and explications, see the materials cited *supra* note 5.

8. See, e.g., A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932); *THE CORPORATION IN MODERN SOCIETY* (E. Mason ed. 1959); Manning, Book Review, 67 *YALE L.J.* 1477, 1485-88 (1958).

9. See *Shark Repellents Discourage Takeovers, Reduce Shareholders' Returns*, 17 *SEC. REG. & L. REP.* (BNA) No. 5, at 195 (Feb. 1, 1985); *Combining Shark Repellents Causes Decline in Stock Prices, SEC Staff Says*, 16 *SEC. REG. & L. REP.* (BNA) No. 44, at 1746 (Nov. 9, 1984).

10. *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), discussed *infra* notes 168-209 and accompanying text.

11. See *infra* notes 392-442 and accompanying text.

12. Similar questions of constitutionality and choice of law would be raised if one or more states were to take an opposite view and seek to restrain management interference with takeovers.

not come within the purview of federal securities law.¹³ This retrenchment was reinforced by a 1979 holding that the termination of derivative actions even for federal securities claims is subject to state corporate law.¹⁴

The Securities and Exchange Commission (SEC) Advisory Committee on Tender Offers supported the preservation of a major role for state corporate law in this area. While it opposed state antitakeover securities regulation for nonlocal companies, it did not favor federal preemption of the field.¹⁵ Instead, it left to state law and the business judgment rule most antitakeover activity, including all defensive actions by management.¹⁶ Only when it came to structural "shark repellents," especially certain supermajority shareholder approval requirements for changes in control—whether imposed by statute or incorporated in the charter or by-laws—did the committee propose federal intervention.¹⁷

Congress has begun taking notice of the committee's recommendations. A House committee approved a Tender Offer Reform Act that incorporates a good number of the recommendations.¹⁸ Under the Act, shareholder consent would be required for some issuer tender offers, for issuance of stock or options to "white knights," and for "greenmail" repurchases; golden parachutes would also be limited. But the SEC,¹⁹ the

13. *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977).

14. *Burks v. Lasker*, 441 U.S. 471 (1979). Recent decisions in the Second Circuit that refuse to treat "lock-up" options granted to "white knights" as manipulative under the Williams Act—thus leaving them to the state business judgment rules—are consistent with this trend. *See, e.g., Data Probe Acquisition Corp. v. Datalab, Inc.*, 722 F.2d 1, 4-7 (2d Cir. 1983) (fairness or unfairness of "lock-up" options is irrelevant under Williams Act), *cert. denied*, 104 S. Ct. 1320 (1984); *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757, 759-60 (2d Cir.), *cert. denied*, 104 S. Ct. 550 (1983); *see also Note, Target Defensive Tactics as Manipulative Under Section 14(e)*, 84 COLUM. L. REV. 228, 252-62 (1984). *But see Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 376-77 (6th Cir. 1981) (management's grant to competing bidder of option to purchase large number of shares was manipulative and hence violated Williams Act).

15. *Report, supra* note 5, Recommendations 9(a), (b).

16. *Id.*, Recommendation 33. It also relegated to state law such matters as fairness of price and appraisal rights, approval of the offer by shareholders of the offeror, *id.*, Recommendation 31, self-tenders, *id.*, Recommendation 39(a), counter tender offers when the main offer is for less than all the stock, *id.*, Recommendation 40, contracts for the sale of stock or assets to "white knights," *id.*, Recommendation 41, and sales of significant assets, *id.*, Recommendation 42.

17. *Id.*, Recommendations 34-35. If such practices were not to be prohibited, the Committee recommended that supermajority provisions should require an equal supermajority vote, and that these matters, as well as disenfranchising provisions, standstill agreements and "golden parachutes," should be reviewed at each annual meeting and voted upon by the shareholders on an "advisory" basis. *Id.*, Recommendations 37-38. Only defensive buyouts of its own stock at a premium by the target would require shareholder approval. *Id.*, Recommendation 43.

18. H.R. 5693, 98th Cong., 2d Sess. (1984) (also known as the Wirth Bill); *see also* 16 SEC. REG. & L. REP. (BNA) No. 31, at 1279 (Aug. 3, 1984).

19. *See SEC Says it Opposes House Measure to Restrict Abusive Takeover Tactics*, 16 SEC. REG. & L. REP. (BNA) No. 36, at 1473-74 (Sept. 14, 1984); *SEC Should Have Power to Bar Executives for*

White House²⁰ and others²¹ expressed their opposition and the Act has been provisionally withdrawn.²² Other proposals have also surfaced: a more limited Senate version of the House bill,²³ and a House bill for a federal business judgment rule placing on a board of directors the burden of justifying its antitakeover actions.²⁴ In the opposite direction, other bills would require tender offerors seeking a certain percentage to extend the offer to all the shares of the target.²⁵ The issue is likely to receive major attention in Congress this year with final action likely to emerge in 1986.²⁶

Securities Violations, Treadway Says, *id.* at 1492. On the undesirability of intrusion into a state law domain, see the comments of Commissioner Marinaccio, *Protect Business Judgment Rule, Restrict RICO*, Marinaccio Urges, 16 SEC. REG. & L. REP. (BNA) No. 37, at 1517-18 (Sept. 21, 1984). It appears that the SEC opposition reflects mostly a disagreement with some aspects of the proposals, especially their breadth, rather than with the need to curb certain tactics. See Block & Hoff, *Legislators Focusing on Takeover Regs*, Legal Times, Nov. 19, 1984, at 16, col. 20.

20. See *Reagan Administration Formally Opposes House Bill to Limit Tender Offer Abuses*, 16 SEC. REG. & L. REP. (BNA) No. 38, at 1546 (Sept. 28, 1984); see also *White House Begs Off on Tender Offer Package*, Legal Times, Sept. 10, 1984, at 3, col. 1. The thrust of the White House opposition is deregulation. *White House Economists Say No Need for Additional Takeover Regulations*, 17 SEC. REG. & L. REP. (BNA) No. 6, at 247 (Feb. 8, 1985).

21. They include a group of investment bankers, see Easton, *Interest in Takeover Reform Picks Up*, Legal Times, Nov. 19, 1984, at 1, col. 17, the National Association of Manufacturers, see *id.*, the National American Securities Administrators Association, see *NASAA Reiterates Position on Tender Offer Legislation to House Committee*, 16 SEC. REG. & L. REP. (BNA) No. 31, at 1292 (Aug. 3, 1984) [hereinafter cited as NASAA], and the American Bar Association, *ABA Votes Against Federal Corporate Legislation*, Legal Times, Feb. 25, 1985, at 4, col. 2.

22. The reasons for opposition, in addition to disagreement on certain particulars, see *supra* notes 17, & 19-20, are mainly intrusion into a field reserved for state law, patchwork reform and interference with the freedom of the market.

23. This version would restrict only greenmail and "golden parachutes." See Block & Hoff, *supra* note 19, at 16; Easton, *supra* note 21, at 18.

24. H.R. 5695, 98th Cong., 2d Sess. (1984) (proposed again by Representative Wirth). See Block & Hoff, *supra* note 19, at 21; Sommer, *Hostile Tender Offer Is Critical Issue for Congress*, Legal Times, Jan. 21, 1985, at 19, col. 2; *Wirth Introduces Bills to Limit Tender Offer Abuses*, 16 SEC. REG. & L. REP. (BNA) No. 24, at 913 (May 5, 1984). Similar bills were introduced in the Senate: S. 2779, 98th Cong., 2d Sess. (1984) by Senator Chafee and S. 2777, 98th Cong., 2d Sess. (1984) by Senator Heinz. The SEC opposes this kind of bill, but the North American Securities Administrators Association (NASAA) supports it. See Block & Hoff, *supra* note 19, at 21; NASAA, *supra* note 21, at 1293. Representative Rodino introduced a bill, H.R. 5137, 98th Cong., 2d Sess. (1984), which would have placed the target's decision on the tender offer solely in the hands of its "independent" directors. See Longstreth, *Change-of-Control Issues Spark Lively Debate*, Legal Times, Oct. 8, 1984, at A-11, col. 2; Sommer, *supra*, at 26.

25. H.R. 5694, 98th Cong., 2d Sess. (1984) (another Wirth bill). Noted antitakeover lawyer M. Lipton has proposed the Shareholder Protection and Elimination of Takeover Abuses Act of 1985, which is even stricter than the Wirth version. See *Lawyer Proposes 5 Percent Rule to Curb Greenmail, Two-Tier Tender Offer Abuses*, 16 SEC. REG. & L. REP. (BNA) No. 47, at 1879 (Nov. 30, 1984). A similar proposal has been made by Senator Metzenbaum and the concept is supported by the NASAA. NASAA, *supra* note 21, at 1293; see also Block & Hoff, *supra* note 19, at 21.

26. See *SEC Enforcement, Financial Services, Accounting Issues Dominate SRI Meeting*, 17 SEC. REG. & L. REP. (BNA) No. 5, at 210, 217 (Feb. 1, 1985).

III. THE DIFFERENCES IN STATE CORPORATE LAWS AND THE IMPORTANCE OF CHOICE

If corporate laws were uniform, or at least basically similar, there would be no practical need to address the choice-of-law question. But this is not the case. Not only are there some notable exceptions to the wide scope of the enabling legislation that prevails in most states, but significant differences in the amount of flexibility granted corporations also exist. The unification of the Law Merchant in the United States, which culminated in the Uniform Commercial Code, has not carried over into corporate law. The Model Business Corporation Act influenced a number of states, but major commercial centers such as New York, California, and Ohio and incorporation states such as Delaware still follow their own separate paths. The American Law Institute project that seeks to unify the basic standards of corporate governance and structure²⁷ is a controversial long-term venture with an uncertain future.²⁸ In addition, the drive for federal minimum standards has stalled.²⁹ Thus, if anything, the trend is away from, rather than toward, uniformity.³⁰

The American Bar Association (ABA) and the Business Roundtable are reportedly engaged in a comprehensive review of the entire takeover field. See Easton, *supra* note 21, at 17.

It goes without saying that the takeover stakes are quite high. During the first nine months of 1984, 1899 merger deals—hostile and friendly—were announced, totaling \$103.2 billion, compared with figures of 1812 deals and \$53.3 billion during the same period in 1983. See *id.*

27. AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (Tent. Drafts Nos. 2 & 3 (1984)) [hereinafter cited as ALI DRAFT RESTATEMENT NOS. 2 & 3]. For an analysis and evaluation of these drafts, see *Symposium on the ALI Corporate Governance Project*, 37 U. MIAMI L. REV. 169, 169-349 (1983); Weiss, *Economic Analysis, Corporate Law and the ALI Corporate Governance Project*, 70 CORNELL L. REV. 1, 3-37 (1984).

28. See Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 946-48 (1983); *ALI Project Will Increase Litigation, Hurt Board, Business Roundtable Says*, 16 SEC. REG. & L. REP. (BNA) No. 43, at 1720-21 (Nov. 2, 1984); *ABA Group Seeks Broader Insider Trading Bill*, Legal Times, May 7, 1983, at 13, col.1; *Corporate Governance*, 50 U.S.L.W. 2705, 2706 (May 1, 1982).

29. See Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 914-15 (1982); *Williams Says Bill on Corporate Governance Standards Would be Counterproductive, Stifles Board Reforms*, 12 SEC. REG. & L. REP. (BNA) No. 580, at A1 (Nov. 26, 1980).

30. According to President Perkins of the American Law Institute:

There can be no doubt that there has been in the last decade an extraordinary ferment of activity in the field of corporate governance Accompanying the ferment, there has been a degree of uncertainty and inconsistency in the law which cries out for dispassionate analysis and the development of guiding principles.

Letter from Roswell B. Perkins to Members of The American Law Institute (January 1982), quoted in Wechsler, *Foreword to PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS* (Tent. Draft No. 1, 1982) [hereinafter cited as ALI DRAFT RESTATEMENT NO. 1].

See also Branson, *Countertrends in Corporation Law: MBCA, British Company Law Reform and ALI's Principles of Corporate Governance and Structure*, 68 MINN. L. REV. 53, 53-72 (1983).

The greater the diversity of corporate law, the more important becomes the choice of the law to apply, especially in the context of the novel and difficult questions raised by the many new devices used in takeover battles. Differences in substantive law have also affected other controversial areas of corporate structure and governance not directly involving control. These include the standards by which waste and conflicts of interest are determined, management indemnification and insurance, the protection of minority shareholders in dissolution or against oppression, freeze-out, or sale of control at a premium, abuse of inside information in securities trading, and, last but not least, the demand requirement and the scope of the business judgment rule, especially in derivative suits implicating management. That differences in the rules may well be outcome-determinative is illustrated by three of the most controversial corporate confrontations of the recent past.

To prevent T. Boone Pickens, Jr., from gaining control, the management of Gulf Oil fought and won a proxy fight to move the company's situs of incorporation from Pennsylvania to Delaware. The principal reason for this reincorporation was to dispense with cumulative voting, increase the percentages necessary to call special meetings of shareholders, and install a variety of "shark repellents" by charter and by-law amendments.³¹

For a summary of the significant differences between Delaware and California law, see Comment, *Choice of Corporate Domicile: California or Delaware*, 13 U.S.F.L. REV. 103, 105-08 (1978). It must also be noted that foreign corporate law not only is substantially different from United States law but is diverse as well. For a description and evaluation of the differences between, for example, American and continental law, see Tunc, *A French Lawyer Looks at American Corporation Law and Securities Regulation*, 130 U. PA. L. REV. 757, 757-74 (1982). Even within the European Economic Community (EEC), the momentum toward limited harmonization of certain features of internal corporate rules is slowing down. See Schneebaum, *The Company Law Harmonization Program of the European Community*, 14 LAW & POL. INT'L. BUS. 293, 300-21 (1982); Silkenat, *Efforts Toward Harmonization of Business Laws Within the EEC*, 12 INT'L. LAW. 835, 837-41 (1978). The attempt to adopt some kind of a "supranational" statute for a *Societas Europa* has not gotten anywhere as of yet. See A. CONARD, *CORPORATION LAW IN PERSPECTIVE* 88-90 (1976); Schneebaum, *supra* at 329-31.

31. See *Future of Gulf Oil Hinges on Proxy Fight Led by Mesa Chairman*, Wall St. J., Nov. 2, 1983, at 1, col. 6; *Gulf Oil Board Seeks Changes in Voting, Charter to Block Possible Takeover Moves*, Wall St. J., Oct. 12, 1983, at 9, col. 2. In February 1984, Pickens announced a takeover plan for Gulf. Gulf's new defensive strategies included a counter tender offer and "poisoning" the well through senior bank credit. See *Gulf Oil Unveils a Two-Pronged Defense to Thwart Pickens Group Takeover Plan*, Wall St. J., Feb. 13, 1984, at 3, col. 1. Eventually, Gulf was "saved" by a "white knight" merger with Chevron.

Similarly, Kaiser Cement is reported to have planned to move its incorporation from California to Delaware to take advantage of the latter's liberality with respect to antitakeover charter provisions and "golden parachute" contracts for management. See *Kaiser Cement Signs Pay Accords, Seeks Incorporation Change to Foil a Takeover*, Wall St. J., Apr. 19, 1982, at 10, col. 2. Baker International changed its incorporation from California to Delaware principally to avoid cumulative voting and to adopt voting provisions intended to discourage a takeover. See 60 CORP. REP. BULL.

When two big defense contractors, Bendix and Martin Marietta, aided eventually by corporate giants Allied and United Technologies, tried to gobble each other up through reciprocal tender offers in what has been called a "Pac Man" takeover,³² it all came down to a question of timing. The spoils were to go to the company first able to control the board of its target. Under the tender offers, Bendix acquired seventy percent of Martin Marietta's stock six days before Martin Marietta could buy any Bendix stock.³³ But how soon could this advantage be translated into board control? Martin Marietta had been incorporated in Maryland where corporate directors cannot be removed by the shareholders without a meeting on ten days notice.³⁴ Bendix, however, was a Delaware corporation, and a majority shareholder could remove the board immediately and without a meeting.³⁵ Thus, Martin Marietta's six-day lag would become a four-day edge upon acquisition of a majority of the stock of Bendix.

But could Martin Marietta exercise its voting power in Bendix, which had already acquired seventy percent of the Martin Marietta shares? Under both Maryland and Delaware law, corporate shares owned by a majority subsidiary cannot be voted.³⁶ Presumably the Dela-

(PH) No. 7, at 8 (Feb. 1, 1983). Friggie International has reportedly been seeking to reincorporate in Delaware from Ohio and to adopt a charter provision to the effect that a shareholder of more than 10% shall have only 1/100th of a vote for each share held in excess of 10%. See *Friggie Anti-Takeover Plan May Threaten Listing on Big Board*, Wall St. J., Apr. 26, 1983, at 24, cols. 5-6. MCI has already adopted such a provision, relying on the unique Delaware precedent of *Providence & Worcester Co. v. Baker*, 378 A.2d 121, 122-24 (Del. 1977) (corporate charter provision for voting power based upon size of individual shareholder's holding is not invalid). See *MCI Limits Shareholder Powers in the British Fashion*, Legal Times, Feb. 18, 1983, at 10, col. 1.

On "migratory mergers" into Delaware corporations to obstruct cash-outs under *Tanzer v. International Gen. Indus.*, 379 A.2d 1121 (Del. 1977) and *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977), and before *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), see *Sanders v. Thrall Car Mfg. Co.*, 582 F. Supp. 945 (S.D.N.Y. 1983).

32. This takeover battle is probably the most celebrated and controversial ever. Books have been written recounting the blows step by step, in docudrama style. See, e.g., H. LAMPERT, *TILL DEATH DO US PART* (1983); A. SLOAN, *THREE PLUS ONE EQUALS BILLIONS: THE BENDIX-MARTIN MARIETTA WAR* (1983). For a drier, chronological summary of the saga, see 1 PRACTICING LAW INSTITUTE, *FOURTEENTH ANNUAL INSTITUTE ON SECURITIES REGULATION* 739-48 (1982) [hereinafter cited as PRACTICING LAW INSTITUTE]; see also Herzel & Schmidt, *SEC is Probing Double Pac-Man Takeover Defense*, Legal Times, Apr. 18, 1983 at 1, col. 2; Masters, *Lawyers Debate Best and Worst of Bendix Takeover Maneuvers*, Legal Times, Oct. 11, 1982 at 2, col. 1. Schmidt, *SEC is Probing Double Pac-Man Takeover Defense*, Legal Times, Apr. 18, 1983, at 1, col. 2.

33. 1 PRACTICING LAW INSTITUTE, *supra* note 32, at 744-46.

34. MD. CORPS. & ASS'NS CODE ANN. §§ 2-406(a), 2-504(a), 2-505 (1975 & Supp. 1984).

35. DEL. CODE ANN. tit. 8, §§ 228(a), 141(k) (1983).

36. MD. CORPS. & ASS'NS CODE ANN. § 2-509(b)(2) (1975); DEL. CODE ANN. tit. 8, § 160(c) (1983). It would appear that a subsidiary may vote the shares that it owns in its parent only if this is permissible under the law governing the internal affairs of both corporations. Cf. *Norlin Hostile Holders Say They Raised Stake in Company to 47.6%*, Wall St. J., Feb. 13, 1984, at 43, col. 3 (voting

ware rule would extend to shareholder action to remove directors without a meeting. Nevertheless, does the disenfranchising rule apply to this strange mutual parent-subsidary situation? The Delaware Chancery Court so held and enjoined Martin Marietta from exercising its voting rights in Bendix.³⁷ Of course, had Martin Marietta been successful in buying enough Bendix stock to exceed fifty percent, both corporations would have been locked in a voting stalemate, with the outcome of the struggle to be decided by the minority shareholders of each in a dual proxy contest. The complex litigation that arose in the federal and state courts in New York, Maryland, Delaware and Michigan involved not only corporate but also antitrust and securities law questions. But the differences in the state laws on removal of directors and voting—as well as on the validity of certain defensive measures—could have proven crucial given the circumstances.³⁸

of "poison pill" preferred shares issued to target's Panamanian subsidiary is authorized under Panamanian law).

37. *Martin Marietta Corp. v. Bendix Corp.*, No. 6942 (Del. Ch. Sept. 21, 1982) (available on LEXIS, States library, Del file), *aff'd*, No. 298 (Del. Sept. 21, 1982).

38. The conflict also involved a host of other significant internal corporate affairs issues relating to the various defensive measures taken against the takeovers:

(a) As a Martin Marietta shareholder, Bendix went to federal court to ask that a special meeting be held on 10-day notice for the purpose of removing the directors. *Id.* But the same directors rushed to amend the bylaws to require a 30-day notice. Was the amendment valid?

(b) While the hostile tender offers were pending, Bendix called a meeting of its own shareholders to amend its certificates to include two "shark repellent" provisions: (1) supermajority requirements for any merger with a shareholder corporation owning 20% or more, unless the directors approved it or the second-step price was equal to the tender offer, and (2) elimination of direct shareholder action without a meeting in director removals and mergers. *Id.* Were these hurried defensive amendments invalid under the rationale of *Schnell v. Chris-Craft Indus.*, 285 A.2d 437 (Del. 1971) (management's use of Delaware law to perpetuate itself in office and to obstruct legitimate efforts of stockholders to undertake a proxy contest against management constituted inequitable conduct)? Were they technically void because the exact language of the amendments was not included in the notice of meeting? The Delaware Court of Chancery was not persuaded that a strong case of invalidity had been made out, and denied a preliminary injunction against holding the meeting to vote on the amendments, *Martin Marietta Corp. v. Bendix Corp.*, No. 6942 (Del. Ch. Sept. 21, 1982) (available on LEXIS, States library, Del. file) *aff'd*, No. 298 (Del. Sept. 21, 1982).

(c) Was the adjournment of the shareholders' meeting of Bendix valid when the management decided not to put the amendments to a vote, but a group of shareholders reconvened and voted them down? See *Marietta Buys Big Hunk of Bendix*, Honolulu Advertiser, Sept. 23, 1982, at B-3, cols. 5-6.

(d) By making a counter tender offer for Bendix stock, did the directors of Martin Marietta breach their fiduciary duty to the corporation and to its majority shareholder? Was this defensive counter tender offer protected by the business judgment rule or was it to be scrutinized for fairness under a conflict-of-interest analysis? See *Martin Marietta Corp. v. Bendix Corp.*, No. Y-82-2560 (D. Md. Sept. 22, 1982) (available on LEXIS, States library, Md file).

(e) Did Bendix violate the inspection rights of its shareholders when it initially refused to give a copy of its shareholder list to Martin Marietta, allowing instead only photographic reproduction of a ledger 10,000 pages long and containing only three names to a page? See *Dirty Tricks Abound in Takeover Business as Well as in Politics*, Wall St. J., Sept. 22, 1982, at 1, col. 4.

Finally, there were celebrated derivative suits in New York, Delaware and Texas by different shareholders against the management of the Zapata Corporation, charging breaches of fiduciary duty and nondisclosures concerning the acceleration of certain stock options.³⁹ The crucial issue in these cases turned out to be whether the board could terminate the suits.⁴⁰ Should a decision to terminate reached by "disinterested"

(f) Did the directors of Bendix breach their fiduciary duty to the corporation by entering into a defensive agreement with Allied for the sale to Allied of Bendix's aerospace electronics group—its "crown jewel"—in the event that Allied's bid for Bendix stock was topped by another company? Was this action protected by the business judgment rule or was it to be subjected to a conflict-of-interest scrutiny? See *Martin Marietta Purchased 42.4% of Bendix Common Stock for 754.5 Million, or \$75 a Share, Despite Attempt by Bendix to Thwart Move with \$2.3 Million Plan to Merge into Allied Corp.; Merger Agreement with Allied Triggered Resignation of Four Bendix Directors*, Wall St. J., Sept. 23, 1982, at 1, cols. 1-3.

(g) Did the directors of Martin Marietta breach their fiduciary duty to their minority shareholders by turning down a new offer by Bendix to buy the remaining 30% stock at a premium over the original tender offer price?

The supervening agreement whereby Allied took over Bendix and made peace with Martin Marietta mooted these issues. But there were other matters as well where the choice of applicable law might have proven crucial. For example, that portion of the agreement where Allied as 39% shareholder of Martin Marietta promised not to acquire more stock or attempt a takeover, and gave the company not only a right of first refusal but also an option to purchase at fixed prices over a ten year period all the stock owned by Allied, was questionable as leading to an unlawful self-perpetuation of Martin Marietta's management. Other terms of the settlement—the price paid by Allied for Bendix stock and the value of exchange for Martin Marietta stock—were vulnerable to waste and conflict-of-interest charges. Bendix shareholders later unsuccessfully sought to include a proposal in the Bendix-Allied merger proxy statement requiring shareholder approval for future tender offers by management. See *Proxy Proposal Not Proper Subject for Action at Bendix Special Meeting*, 15 SEC. REG. & L. REP. (BNA) No. 1, at 24 (Jan. 7, 1983).

The conflict between Coastal Corporation and Houston Natural Gas Corporation, including not only a "Pac Man" defense but also a competing self-tender offer, promised to match or surpass the Bendix-Martin Marietta saga before it was abruptly settled. See *Houston Natural Gas Sues Coastal, Seeking to Void Series of Antitakeover Steps*, Wall St. J., Feb. 2, 1984, at 14, cols. 3-4; *Houston Natural Gas Moves to Block Offer by Coastal Corp. to Buy Own Shares*, Wall St. J., Feb. 6, 1984, at 3, col. 2; *Houston Natural's Lenders Could Gain Control Under Plan*, Wall St. J., Feb. 7, 1984, at 16, col. 6; *Coastal's Wyatt Says He'll Sell to Anyone But Wants Much More Than \$50 a Share*, Wall St. J., Feb. 8, 1984, at 7, cols. 1-2.

For other recent battles, see, e.g., *Shell Oil Holders Sue to Block Buyout Bid by Royal Dutch/Shell*, Wall St. J., Feb. 2, 1984, at 14, col. 3; *Murdoch Bid to Block Chris-Craft Swap With Warner is Denied by Delaware Court*, Wall St. J., Jan. 13, 1984, at 4, col. 1.

The two major takeover battles in the second half of 1984, Limited and Carter Hawley, and Pickens and Phillips Petroleum, involved a host of similar issues.

39. See *Maher v. Zapata Corp.*, 714 F.2d 436, 465 (5th Cir. 1983); *Maldonado v. Flynn*, 485 F. Supp. 274, 277-78 (S.D.N.Y. 1980), *rev'd per curiam*, 671 F.2d 729 (2d Cir. 1982); *Maldonado v. Flynn*, FED. SEC. L. REP. (CCH) ¶ 99,553 (S.D.N.Y. Nov. 3, 1983); *Maher v. Zapata Corp.*, 490 F. Supp. 348, 349 (S.D. Tex. 1980); *Maldonado v. Flynn*, 448 F. Supp. 1032, 1034-35 (S.D.N.Y. 1978), *aff'd in part, rev'd in part*, 597 F.2d 789 (2d Cir. 1979); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 780-81 (Del. 1981).

40. [A]fter a century of development in the law of derivative action in this country, many of the critical issues posed by suits against directors remained unresolved. Despite the current judicial trend to conclude that disinterested directors do have the power to dismiss such suits, in fact even that basic issue has been squarely addressed by the highest courts in

directors be scrutinized under conflict-of-interest criteria or does it enjoy the protection of the business judgment rule? How is "disinterest" to be assessed? Who has the burden of proof? More particularly, can the decision be insulated from a conflict-of-interest challenge through the delegation to an "independent" litigation committee? To what extent, if any, is the decision of such a committee reviewable on the merits by the court? Under the authority of *Santa Fe Industries v. Green*⁴¹ and *Burks v. Lasker*,⁴² courts have applied state corporate law to such termination power even where a federal securities claim is asserted. The only exception is where federal interest is deemed to be frustrated by the application of a lax state standard.⁴³ State law on termination power varies greatly,⁴⁴

only two states, New York and Delaware. Further, as we have seen, even where the power to terminate is recognized, there is no consensus as to who is sufficiently disinterested to be entitled to make such a determination for the corporation, or as to the nature and scope of the judicial review of such determinations. Indeed, *Auerbach* and *Zapata*, far from resolving the latter crucial issue, have highlighted the vast differences of opinion which exist within the judiciary.

Block & Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata?*, 37 BUS. LAW. 27, 63-64 (1981). See also Buxbaum, *Conflict-of-Interests Statutes and the Need for a Demand on Directors in Derivative Suits*, 68 CALIF. L. REV. 1122, 1123 (1980) (discussing the importance of demand requirement); Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 262 (1981) (demand requirement viewed as major threat to derivative suits).

41. 430 U.S. 462 (1977).

42. 441 U.S. 471 (1979).

43. Such a rare situation was *Galef v. Alexander*, 615 F.2d 51, 64 (2d Cir. 1980) ("federal policy prevents the summary dismissal of those [section 14(a)] claims pursuant to the business judgment of those defendant directors"). In another section 14(a) case, the court reached a different conclusion because there was "no causal link between the challenged nondisclosures . . . and [the] election." *In re General Tire & Rubber Co. Sec. Litig.*, 726 F.2d 1075, 1077 (6th Cir.), cert. denied, 105 S. Ct. 187 (1984).

44. New York leads the way in maximizing termination power. See *Stein v. Bailey*, 531 F. Supp. 684, 693-96 (S.D.N.Y. 1982); *Auerbach v. Bennett*, 64 A.D.2d 98, 106, 408 N.Y.S.2d 83, 87 (1978), modified, 47 N.Y.2d 619, 633-34, 393 N.E.2d 994, 1002, 419 N.Y.S.2d 920 (1979). Cases demonstrating that other states have been strengthening termination power include *Gaines v. Haughton*, 645 F.2d 761, 770-79 (9th Cir. 1981) (California law); *Greenspun v. Del. E. Webb Corp.*, 634 F.2d 1204, 1208-10 (9th Cir. 1980) (Arizona law); *Clark v. Lomas & Nettleton Fin. Corp.*, 625 F.2d 49, 53-54 (5th Cir. 1980) (Texas law), cert. denied, 450 U.S. 1029 (1981); *Abbey v. Control Data Corp.*, 603 F.2d 724, 729-30 (8th Cir. 1979) (Delaware law), cert. denied, 444 U.S. 1017 (1980); *Abella v. Universal Leaf Tobacco Co.*, FED. SEC. L. REP. (CCH) ¶ 98,836 (E.D. Va. Sept. 7, 1982); *Genzer v. Cunningham*, 498 F. Supp. 682, 687-97 (E.D. Mich. 1980); *Siegal v. Merrick*, 84 F.R.D. 106, 108-11 (S.D.N.Y. 1979); *Rosengarten v. ITT*, 466 F. Supp. 817 (S.D.N.Y. 1979); *Gall v. Exxon*, 418 F. Supp. 508, 517-19 (S.D.N.Y. 1976); *Klotz v. Consolidated Edison*, 386 F. Supp. 577, 581-89 (S.D.N.Y. 1974).

While Delaware started at the opposite end of the spectrum, see, e.g., *Maldonado v. Flynn*, 413 A.2d 1251, 1252 (Del. Ch. 1980) (directors may not terminate derivative suit once demand excused), *rev'd*, 430 A.2d 779, 788-89 (Del. 1981) (court should exercise independent business judgment), it has finally espoused a moderate position which allows for court review of the merits of the termination decision, but only when the board which appointed the committee is clearly implicated. See *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1981) (where demand on the board is excused due to futility, terminations will be upheld only if (a) the corporation shows that the deci-

and these diverse responses underscore the importance of choosing which law to apply.

IV. THE CONTINUING PREVALENCE OF THE LAW OF THE STATE OF INCORPORATION FOR DETERMINING INTERNAL CORPORATE AFFAIRS: THE MINIMAL IMPACT OF THE CONFLICTS REVOLUTION

A. *Judicial Practice.*

1. *The Traditional Rule.* An established rule of traditional conflicts—developed by the courts in the absence of legislative intervention—is that the internal corporate relationship is governed by the law of the state of incorporation.⁴⁵ While the scope of “internal affairs” has not been defined with mathematical precision, the subject is not controversial. There is little doubt that internal affairs include the corporate organizational structure and the relationships between shareholders and managers and among shareholders inter se. There is a general consensus on most issues that come within the term.⁴⁶

sion makers were independent and acted in good faith after reasonable investigation, and (b) the court, applying its own independent business judgment, is satisfied that a contrary result is not required by the best interests of the corporation or as a matter of law or public policy). The applicability of this intermediate standard has been adversely affected by recent ambiguous decisions in Delaware on the question of when demand is excused. *See Pogostin v. Rice*, 480 A.2d 622 (Del. 1984); *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

The *Zapata* position received a major boost by the Second Circuit's conclusion that, in the absence of any meaningful precedent, Connecticut is likely to follow it because it is more consistent with the concept of fiduciary responsibility. *See Joy v. North*, 692 F.2d 880, 888-93 (2d Cir. 1982), *cert. denied*, 103 S. Ct. 1498 (1983).

Section 7.03(c) of the ALI DRAFT RESTATEMENT NO. 1, *supra* note 30, adopts a refined version of the *Maldonado* standard. *Cf. Hasan v. Cleve-Trust Realty Investors*, 729 F.2d 372 (6th Cir. 1984); *Watts v. Des Moines Register & Tribune Co.*, 525 F. Supp. 1311, 1329 (S.D. Iowa 1981) (defendants must show reasonable basis for special litigation committee's decision to terminate). On the desirability of an intermediate standard, see Block & Prussin, *supra* note 40, at 72. The Iowa Supreme Court recently adopted a stricter approach by holding that where a majority of the directors are defendants, the board has no authority to delegate the termination decision to a committee; it may, however, petition the court for the appointment of a special panel. *See Miller v. The Register & Tribune Syndicate, Inc.*, 336 N.W.2d 709, 716-18 (Iowa 1983).

45. *See* RESTATEMENT OF THE CONFLICTS OF LAWS §§ 152-161, 163, 182-185, 187 (1934) [hereinafter cited as FIRST RESTATEMENT]; 2 J. BEALE, CONFLICT OF LAWS 893-98 (1935); R. LEFLAR, AMERICAN CONFLICTS LAW § 255 (3d ed. 1977); *see also* Hadari, *The Choice of National Law Applicable to the Multinational Enterprise and the Nationality of Such Enterprises*, 1974 Duke L.J. 1, 20.

46. *The Restatement (Second) of the Conflict of Laws* (1971) contains perhaps the most comprehensive listing of “internal affairs” matters. The listing includes, in particular: (1) “the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, preemptive rights, the holding of directors’ and shareholders’ meetings, methods of voting including any requirement for cumulative voting, shareholders’ rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganizations and the reclassification of shares,” RESTATEMENT (SECOND) OF THE CONFLICT OF LAWS § 302 com-

The last comprehensive review of the status of the lex incorporationis in the courts was done in 1958 by Professors Reese and Kaufman who, in a lengthy article, documented its general prevalence and explored its rationale.⁴⁷ The article was prompted by the famous case of *Western Air Lines v. Sobieski*,⁴⁸ where the California courts eventually upheld an order of the Commissioner of Corporations which in effect required a Delaware corporation having major California contacts to adopt cumulative voting as mandated by California law. Although there were ambiguities in the case and the result reached could have been justified on the alternate ground that Western Air Lines was a pseudo-foreign corporation, Reese and Kaufman not only disagreed with the decision on conflicts grounds but also raised doubts about whether it was consistent with the full faith and credit clause.⁴⁹

2. *The Implications of the Conflicts Revolution.* Then came the "conflicts revolution," which profoundly affected conflicts theory and practice in a majority of the states,⁵⁰ and whose premises and methods have major implications for choice of law in all fields, including corporations. The common denominator of the new conflicts theory is the abandonment of choice-of-law rules in favor of methodologies that examine all the circumstances of each case in light of all potentially relevant considerations. In the new conflicts calculus, the interests and policies of the forum state, especially the protection of forum domiciliaries, weigh heavily in favor of applying its law—the "lex fori." Fixed, single-factor, content-blind, forum-neutral rules are supposed to be particularly obnoxious because they defer automatically and totally to one legal system in disre-

ment a (1971) [hereinafter cited as RESTATEMENT (SECOND)]; (2) "the declaration and payment of dividends and other distributions . . . and the purchase and redemption by the corporation of outstanding shares of its own stock," *id.*, at comment e; (3) "who are shareholders," *id.*, § 303; (4) the "right of a shareholder to participate in the administration of the affairs of the corporation, in the division of profits and in the distribution of assets on dissolution and his rights on the issuance of new shares," *id.*, § 304; (5) "whether shares in a voting trust may be voted by the trustees," *id.*, § 305; (6) "[t]he obligations owed by a majority shareholder to the corporation and to the minority shareholders," *id.*, § 306; (7) "the existence and extent of a shareholder's liability to the corporation . . . and to its creditors for corporate debts," *id.*, § 307; (8) and "the existence and extent of a director's or officer's liability to the corporation, its creditors and shareholders," *id.*, § 309. For other enumerations, see Hadari, *supra* note 45, at 15-17; Reese & Kaufman, *supra* note 1, at 1124.

47. Reese & Kaufman, *supra* note 1, at 1124-28.

48. 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961).

49. Reese & Kaufman, *supra* note 1, at 1141, 1144.

50. Professor Sedler recently counted 31 states in the new conflicts camp. See Sedler, *Interest Analysis and Forum Preference in the Conflict of Laws: A Response to the 'New Critics'*, 34 MERCER L. REV. 593, 593 n.4 (1983). Professor Kay's count is 29. See Kay, *Theory Into Practice: Choice of Law in the Courts*, 34 MERCER L. REV. 521, 591-92 (1983) (appendix).

gard of the interests and policies of the other states of contact.⁵¹ The lex incorporationis is precisely such a rule.

The *Western Air Lines* case was to be the harbinger of a new conflicts approach in corporate law that would limit or perhaps discard the lex incorporationis. The wisdom of Professor Latty's writings on "pseudo-foreign" corporations⁵² was rediscovered and the primacy of local corporate policy over the lex incorporationis was vigorously stressed by such authors as Kaplan⁵³ and Baraf.⁵⁴ Bellwether states such as California and New York enacted or redefined significant deviations from it.⁵⁵ The *Restatement (Second)* extends an open invitation to depart from the lex incorporationis principle on issues with respect to which another state has a "more significant relationship" to the corporation, the transaction, the shareholders, or the parties.⁵⁶ Because corporate shareholders, assets, business, and management are often located in, and transactions often take place in, states other than that of incorporation, the exaltation of local corporate policy and local interests could have severely undermined the traditional system based on the lex incorporationis.

3. *The Actual Impact of the Conflicts Revolution Upon Choice of Law for Internal Corporate Affairs.* It should be noted at the outset that a substantial percentage of all corporate law cases are potentially conflicts cases in the sense that the corporation, parties, or transactions have contacts with more than one state. Yet a review of cases decided over the last twenty-five years reveals that, despite the conflicts revolution, in all but a handful of these the law of the state of incorporation was applied

51. For a fuller exploration of the implications of the new conflicts for corporate choice of law, see *infra* notes 221-31 and accompanying text. The literature on the new conflicts methodologies is voluminous. For a summary review of their fundamentals and common elements, see 1 E. SCOLES & P. HAY, *CONFLICT OF LAWS* 16-46 (1983); Leflar, *Choice of Law: A Well-Watered Plateau*, *LAW & CONTEMP. PROBS.*, Spring 1977, 1, at 10-26; *Resolved that Interest Analysis is a Proper (Just? Rational?), Adequate (Sufficient?) and Practical (Efficient?) Method (Perhaps the Best? Perhaps Constitutionally Required?) to Choose the Applicable Law*, 46 *OHIO ST. L. J.* — (forthcoming 1985).

52. See, e.g., Latty, *Pseudo-Foreign Corporations*, 65 *YALE L.J.* 137 (1955).

53. See Kaplan, *supra* note 1, at 476-81. More recently, Professor Sargent appears receptive to a more open-ended approach to corporate choice of law, at least in the context of the antitakeover statutes. See Sargent, *Do the Second-Generation State Takeover Statutes Violate the Commerce Clause?*, 8 *CORP. L. REV.* 3, 16-22 (1985).

54. See Baraf, *The Foreign Corporation: A Problem in Choice-of-Law Doctrine*, 33 *BROOKLYN L. REV.* 219, 251-52 (1967).

55. See *infra* notes 275-79, 325-29 and accompanying text.

56. *RESTATEMENT SECOND*, *supra* note 46, §§ 302-306, 309 (allowing state other than the state of incorporation to apply its laws if it "has the more significant relationship to the occurrence and the parties").

without any discussion. What Professor Kaplan observed fifteen years ago is, if anything, even more true today:

The umbilical tie of the foreign corporation to the state of its charter is usually still religiously regarded as conclusive in determining the law to be applied in intracorporate disputes. The fundamental reexamination of the nature of conflict of laws over the past few years has virtually left foreign corporation matters remaining as a pocket of the past in a subject area which has otherwise been characterized by free inquiry, change and flux.⁵⁷

Let us briefly illustrate the continuing supremacy of the lex incorporationis in the courts by visiting some of the most controversial areas of recent times. The New York and California experiences, where there is substantial statutory regulation of the internal affairs of certain foreign corporations, will be addressed separately later on.

a. *Takeover battles.* It is quite remarkable that in the legendary Bendix/Martin Marietta/United Technologies/Allied conflict,⁵⁸ it was taken for granted that the various internal affairs issues involved were subject to Delaware and Maryland law, respectively, simply because Bendix and Martin Marietta had incorporated there. There was no inquiry whatsoever into whether these corporations had any real connections to their states of incorporation or to other states. In particular, no attention was paid to the well-known facts that the business of both corporations was national in scope and that while Martin Marietta had some contacts with Maryland, Bendix had no significant relationship with Delaware. Its principal place of business and headquarters were in fact located in Michigan.⁵⁹

In the famous case of *Panter v. Marshall Field Co.*,⁶⁰ which takes a most permissive view of the availability of the "business judgment" rule to legitimize all sorts of aggressive defensive tactics in tender offers, the court applied the law of Delaware as a matter of course even though the company's headquarters were located in Illinois and it did business in Washington, Ohio, and Pennsylvania, but not in Delaware.⁶¹ In another takeover shoot-out, *Lewis v. Knutson*,⁶² the court again applied Dela-

57. Kaplan, *supra* note 1, at 464.

58. See *supra* notes 32-38 and accompanying text.

59. It was by virtue of this Michigan connection that Bendix was able to obtain a cease-and-desist order from the Michigan Department of Commerce and, later, a court order against the Martin Marietta and United Technologies tender offers. The Michigan statute was eventually declared to be unconstitutional. See *Martin Marietta Corp. v. Bendix Corp.*, 690 F.2d 558, 565-68 (6th Cir. 1982).

60. 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981).

61. *Id.* at 277-78, 293.

62. 669 F.2d 230 (5th Cir. 1983) (shareholder charged management and certain controlling shareholders with waste in taking certain defensive and later collaborationist actions—proxy fight, then purchase of stock—and in seeking unlawfully to freeze him out by a reverse stock split).

ware law merely because of the company's incorporation there, despite the location of its principal place of business in Texas.⁶³ In a recent case involving notorious "raider" Carl C. Icahn's potential looting of Dan River, Inc.—a Virginia corporation engaged in national business and listed on the New York Stock Exchange—the court assessed the justification of defensive actions under the corporate law of Virginia without any conflicts discussion.⁶⁴ In addition, several corporate defensive "nigrations" to Delaware by Gulf and other companies, motivated by law shopping in reliance on the *lex incorporationis*, have recently occurred.⁶⁵

Not a single takeover case has been identified where, in the absence of a relevant statute, the application of a corporate law other than that of the state of incorporation was ever seriously considered. Furthermore, the *lex incorporationis* principle is generally treated as axiomatic. In one case concerning the constitutionality of the Delaware tender offer statute, some explanation was attempted by way of dicta.⁶⁶ The court referred to Delaware's primary interest in attracting investors to its corporations and in protecting their expectations that Delaware law would apply. The court also pointed to the tri-contractual choice of Delaware law by the parties—corporation/ state, corporation/shareholders, and shareholders inter se—and stressed the importance of giving effect to the contract not only within but also outside of the Delaware boundaries.⁶⁷

b. *Termination of derivative suits.* In another controversial and nuanced area of internal affairs, the termination of derivative suits by directors, the applicable rules have again been chosen, without exception, from the law of the state of incorporation.⁶⁸ Again, the courts have usu-

63. *Id.* at 235. The only support cited was the old case of *Rogers v. Guaranty Trust Co.*, 288 U.S. 123, 130 (1933) (involving assessments on stock; stockholders implicitly agreed that internal affairs of company were to be governed by laws of state of incorporation).

64. See *Dan River, Inc. v. Icahn*, 701 F.2d 278, 280-83, 291-92 (4th Cir. 1983). Other takeover cases applying the *lex incorporationis* without elaboration include *Treco, Inc. v. Land of Lincoln Savings & Loan*, 749 F.2d 374, 377 (7th Cir. 1984) (applying rule to antitakeover bylaw changes); *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 374-84 (2d Cir. 1980) (applying rule to issuance of shares to friendly suitor, sale of controlling shares at premium, and corporate opportunity); *Crouse-Hinds Co. v. Internorth, Inc.*, 518 F. Supp. 390, 402 n.15, 406-10 (S.D.N.Y.) (applying rule to issuance of stock, standing to sue, and business purpose of defensive merger), *aff'd*, 634 F.2d 690 (2d Cir. 1980); *Jolinson v. Trueblood*, 629 F.2d 287, 292 (3rd Cir. 1980) (applying rule to breach of fiduciary duty of directors and majority shareholders).

65. See *supra* note 31.

66. See *Wylain, Inc. v. TRE Corp.*, 412 A.2d 338, 344 (Del. Ch. 1980).

67. *Id.* at 344.

68. See *infra* notes 69-75. This is confirmed in the ALI DRAFT RESTATEMENT NO. 1, *supra* note 30, § 7.03 comment a: "The great majority of the recent decisions have been federal court decisions interpreting the *substantive corporate law of the state of incorporation*." (Emphasis added). The law of incorporation was chosen as such, without regard to whether it coincided with the law of the forum. But see Carter, *The Statutory Basis for Dismissal of Stockholder Derivative Actions by*

ally supplied no explanation for this choice.⁶⁹ In some cases, the court mentioned that the parties conceded the applicability of the *lex incorporationis* or did not suggest any other law.⁷⁰ In others⁷¹ the court has simply cited *Cort v. Ash*,⁷² *Santa Fe Industries v. Green*,⁷³ or *Burks v. Lasker*⁷⁴ for the proposition that it is the law of the state of incorporation that determines whether directors have the power to dismiss a pending derivative suit by invoking the business judgment rule. It is true that in each of these three cases the law that was chosen was that of the state of incorporation; in *Cort* there was some reference to the corporation being a "creature" of state law.⁷⁵ The question of choice, however, was neither at issue nor addressed by the Supreme Court in any way.

The only case involving some discussion of choice of law is *Hasan v. CleveTrust Realty Investors*.⁷⁶ This is a special case because the plaintiff forced the new conflicts question: He argued that a jurisdiction like Ohio

Directors, 9 J. CORP. L. 199, 213-14 (1984) (arguing, rather unpersuasively, for the application of the *lex fori*, by analogizing from the "security-for-expenses" cases—the issues are significantly different).

69. See, e.g., *In re General Tire & Rubber Co. Sec. Litig.*, 726 F.2d 1075, 1080 (6th Cir.), *cert. denied*, 105 S. Ct. 187 (1984); *Abramowitz v. Posner*, 672 F.2d 1025, 1026 (2d Cir. 1982) (Delaware law); *Maldonado v. Flynn*, 671 F.2d 729, 731 (2d Cir. 1982) (Delaware law); *Gaines v. Haughton*, 645 F.2d 761, 765 (9th Cir. 1981) (California law); *Lewis v. Anderson*, 615 F.2d 778, 781 (9th Cir. 1979) (California law), *cert. denied*, 449 U.S. 869 (1980); *Mills v. Esmark, Inc.*, 544 F. Supp. 1275, 1281-82 (N.D. Ill. 1982) (Delaware law); *Stein v. Bailey*, 531 F. Supp. 684, 692 (S.D.N.Y. 1982) (Delaware law); *Abella v. Universal Leaf Tobacco Co.*, FED. SEC. L. REP. (CCH) ¶ 98,836, at 94,297 (E.D. Va. 1982) (Virginia law); *Grossman v. Johnson*, 89 F.R.D. 656, 662 (D. Mass. 1981) (Maryland law), *aff'd*, 674 F.2d 115 (1st Cir.), *cert. denied*, 459 U.S. 1138 (1982); *Watts v. Des Moines Register & Tribune*, 525 F. Supp. 1311, 1314 (S.D. Iowa 1981) (Iowa law); *Joy v. North*, 519 F. Supp. 1312, 1316 (D. Conn. 1981) (Connecticut law), *rev'd on other grounds*, 692 F.2d 880 (2d Cir. 1982); *Crane v. Harsco Corp.*, 511 F. Supp. 294, 304-05 (D. Del. 1981) (Delaware law); *Maldonado v. Flynn*, 485 F. Supp. 274, 278 n.9 (S.D.N.Y. 1980) (Delaware law); *Gall v. Exxon Corp.*, 418 F. Supp. 508, 510 (S.D.N.Y. 1976) (New Jersey law); *Issner v. Aldrich*, 254 F. Supp. 696, 700 n.1 (D. Del. 1966) (Virginia law); *Roberts v. Alabama Power Co.*, 404 So.2d 629, 631-32 (Ala. 1981) (Alabama law); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 781 (Del. 1981) (Delaware law); *Auerbach v. Bennett*, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 999-1000, 419 N.Y.S.2d 920, 931 (1979) (New York law); *Swenson v. Thibault*, 39 N.C. App. 77, 98-102, 250 S.E.2d 279, 293-95 (1978) (North Carolina law), *appeal dismissed*, 296 N.C. 740, 254 S.E.2d 181 (1979).

70. See *Clark v. Lomas & Nettleton Fin. Corp.*, 625 F.2d 49, 52 n.3 (5th Cir. 1980) (Texas law), *cert. denied*, 450 U.S. 1029 (1981); *Abbey v. Control Data Corp.*, 603 F.2d 724, 728-29 (8th Cir. 1979) (Delaware law), *cert. denied*, 444 U.S. 1017 (1980); *Cramer v. GTE*, 582 F.2d 259, 275 (3d Cir. 1978) (New York law), *cert. denied*, 439 U.S. 1129 (1979); *Abramowitz v. Posner*, 513 F. Supp. 120, 126 (S.D.N.Y. 1981) (Delaware law), *aff'd*, 672 F.2d 1025 (2d Cir. 1982); *Genzer v. Cunningham*, 498 F. Supp. 682, 686 (E.D. Mich. 1980) (Michigan law).

71. See, e.g., *Maldonado v. Flynn*, 413 A.2d 1251, 1257 (Del. Ch. 1980), *rev'd on other grounds*, 430 A.2d 779 (Del. 1981).

72. 422 U.S. 66 (1975).

73. 430 U.S. 462 (1977).

74. 441 U.S. 471 (1979).

75. 422 U.S. at 84.

76. 548 F. Supp. 1146 (N.D. Ohio 1982), *vacated on other grounds*, 729 F.2d 372 (6th Cir. 1984).

penses of opposing the action,⁸⁶ pro-rata recovery directly to the shareholders,⁸⁷ security for expenses⁸⁸ and, last but not least, demand requirements on directors⁸⁹ and shareholders.⁹⁰

The manner in which the demand-on-directors and demand-on-shareholders requirements of Rule 23.1 of the Federal Rules of Civil Procedure are applied by the federal courts—in both federal question and diversity cases where they differ from those of the state law applicable to the corporation—is too tangential and complex an issue to be considered here. While these requirements could also serve a procedural purpose—that is, closing the federal courts to certain types of derivative claims—the history and language of the Rule and the internal-affairs nature of these requirements strongly support the application of state law.⁹¹

incorporation state governs standing to sue); *Lowell & Wiper Supply Co. v. Helen Shops, Inc.*, 235 F. Supp. 640 (S.D.N.Y. 1964) (law of Tennessee governs standing of pledgee to sue); see also 7A C. WRIGHT & A. MILLER, *FEDERAL PRACTICE & PROCEDURE* § 1826 (1972) ("Under prevailing conflicts principles, state law typically will direct that a plaintiff's status be tested by the law of the corporation's state of incorporation." (citation omitted)).

85. See *Saylor v. Bastedo*, 82 F.R.D. 440, 442 n.2 (S.D.N.Y. 1979) (law of incorporation state governs proof of ownership of stock), *aff'd in part*, 623 F.2d 230 (2d Cir. 1980).

86. *Alleghany Corp. v. Kirby*, 218 F. Supp. 164, 186-87 (S.D.N.Y. 1963) (New York conflicts rule—law of incorporation state).

87. For discussion and authorities, see Grenier, *Prorata Recovery by Shareholders on Corporate Causes of Action as a Means of Achieving Corporate Justice*, 19 WASH. & LEE L. REV. 165, 194-97 (1962).

88. See *Fielding v. Allen*, 181 F.2d 163, 168 (2d Cir.), *cert. denied*, 340 U.S. 817 (1950). See also 7A C. WRIGHT & A. MILLER, *supra* note 84, at § 1826. Cf. *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 554-55 (1949) (fact that corporation incorporated in Delaware is subject to shareholder's derivative action in New Jersey does not make applicable New Jersey statute providing plaintiff with security for expenses); *McClure v. Borne Chem. Co.* 292 F.2d 824, 831 (3d Cir. 1961) (reference to federal law to determine need for security for expenses).

89. See *Lewis v. Curtis*, 671 F.2d 779, 784-87 (3d Cir.) (Pennsylvania law applied to Pennsylvania corporations), *cert. denied*, 459 U.S. 880 (1982); *Cramer v. GTE*, 582 F.2d 259, 275-76 (3d Cir. 1978) (both counsel concede applicability of law of state of incorporation), *cert. denied*, 439 U.S. 1129 (1979); *Swanson v. Traer*, 249 F.2d 854, 855 (7th Cir. 1957) (Illinois law of demand applied to Illinois corporation).

90. See *Jacobs v. Adams*, 601 F.2d 176, 179-80 (5th Cir. 1979) (applying Florida law as the law of state of incorporation); *Rosengarten v. Buckley*, 565 F. Supp. 193 (D. Md. 1983) (applying Maryland law as law of state of incorporation); *Wolgin v. Simon*, 552 F. Supp. 308, 310 (E.D. Mo. 1982) (applying Missouri law as law of state of incorporation), *aff'd*, 722 F.2d 389 (8th Cir. 1983); *Leff v. CIP Corp.*, 540 F. Supp. 857, 869 (S.D. Ohio 1982) (applying Ohio law as law of state of incorporation); *Jones v. Equitable Life Ass'n*, 409 F. Supp. 370 (S.D.N.Y. 1975) (applying Massachusetts law as law of state of incorporation).

91. In his concurrence in *Daily Income Fund, Inc. v. Fox*, 104 S. Ct. 831, 842 (1984), Justice Stevens read the demand-on-directors language of Rule 23.1 to require merely a factual statement by plaintiff whether he had made a demand or why he had failed to do so. The issue itself was subject to state law: "It cannot be doubted that [the demand-on-directors] requirement, designed to improve corporate governance, is of substantive law." *Id.* at 843 n.2. The majority appeared to agree, but felt that it was not necessary to decide the issue in view of its holding that the action, under The Investment Company Act of 1940, Pub. L. No. 91-547, § 36(b), 84 Stat. 1413, 1428 (current version at 15 U.S.C. § 80a-35(b) (1982)) was not "derivative." *Id.* at 837 n.8. See also *Weiss v. Temporary*

which has adopted the modern "balancing of interests" conflicts methodology must necessarily have extended it to internal corporate affairs and must, therefore, have abandoned the rigid *lex incorporationis*.⁷⁷ The plaintiff's position was that the law of Ohio should govern because Cleve-Trust, while organized as a business trust under the law of Massachusetts, had its principal, if not exclusive, place of business in Ohio and had no apparent connection to Massachusetts. The court, however, gave short shrift to this argument. It shrugged off the importance of the conflicts revolution, pointing out that the new conflicts cases dealt with the *lex loci delicti*—the place of the wrong—and "are simply not applicable to the present case."⁷⁸ The court reiterated the axiom that choice of law dictates that "[q]uestions of corporate governance are to be decided under the law of the state of incorporation."⁷⁹

c. *Other aspects of derivative suits.* The application of the *lex incorporationis* is also generally consistent with the practice of courts in deciding substantive aspects of derivative actions. The landmark case is *Hausman v. Buckley*,⁸⁰ a decision that in recent years has been cited in all contexts, perhaps more often than any other, in support of the *lex incorporationis*. This and subsequent New York cases will be discussed at length in the context of the special New York regime.⁸¹

Outside New York, the courts continue routinely to choose the law of incorporation—whenever state law is applicable—to resolve almost every major derivative suit issue, such as: the availability of the derivative action,⁸² whether the action is direct or derivative,⁸³ standing to sue,⁸⁴ proof of stock ownership,⁸⁵ charging to the corporation the ex-

77. *Id.* at 1149. The substantive issues in the case concerned the termination, by a disinterested committee, of a derivative suit charging waste in the defensive purchase and sale of shares to oppose a takeover.

78. *Id.* at 1148.

79. *Id.* (citing RESTATEMENT SECOND, *supra* note 46, § 302). The Court of Appeals was equally axiomatic on this question: "Because Cleve-Trust is a Massachusetts Corporation, the law of that state governs this action." 729 F.2d at 375. A similar approach has been taken, under New York law, in *Galef v. Alexander*, 615 F.2d 51 (2d Cir.1980), discussed *infra* note 370.

80. 299 F.2d 696 (2d Cir.), *cert. denied*, 369 U.S. 885 (1962).

81. See *infra* notes 350-91 and accompanying text.

82. See *Levine v. Milton*, 42 Del. Ch. 597, 599-600, 219 A.2d 145, 147 (1966). (Delaware rejects "center of gravity"; Panamanian law applicable to Panamanian company, citing *Hausman*).

83. See *Downey v. Vernitron Corp.*, 559 F. Supp. 1081, 1086-87 (D. Mass. 1982) (Massachusetts applies law of incorporation state); *Gadd v. Pearson*, 351 F. Supp. 895, 901-02 (M.D. Fla. 1972) (Florida conflicts rule stated in traditional terms; Bahamian law governs nature of action as direct or derivative).

84. See *Fleegeer v. Clarkson Co.*, 86 F.R.D. 388, 394 (N.D. Tex. 1980) (Canadian law governs); *Kreindler v. Marx*, 85 F.R.D. 612, 616 (N.D. Ill. 1979) (Delaware law as law of incorporation state applies to contemporaneous ownership requirement); *Brooks v. Weiser*, 57 F.R.D. 491, 494 (S.D.N.Y. 1972) (federal courts look to law of incorporation state—here, Delaware—to determine status of shareholders); *Rosenfeld v. Schwitzer Corp.*, 251 F. Supp. 758, 761 (S.D.N.Y. 1966) (law of

d. *Freezeouts and squeezeouts.* The abusive elimination of minority shareholders through mergers, reverse stock splits, or a combination thereof has recently received substantial attention. What are the fiduciary duties of management and controlling shareholders in these situations? Is there a "business purpose" requirement and, if so, who has the burden of proof? What price is "fair"?⁹² In the absence of express statutory provisions, the courts in the various states have been moving in different directions and, even in Delaware,⁹³ charting a course has not been easy. Whatever authority exists supports the applicability of the law of the state of incorporation to these issues.⁹⁴

Inv. Fund, Inc., 692 F.2d 928, 946 (3d Cir. 1982) (Gibbons, J., dissenting on other grounds) (demand requirement is substantive rule, constitutionally requiring application of state law as long as state law does not contravene policies of federal law regarding business judgment rule). The language of the Rule—"if necessary"—would a fortiori extend the Stevens-Gibbons analysis to the demand-on-shareholders requirement. A different interpretation of Rule 23.1 would be of dubious constitutionality under *Hanna v. Plumer*, 380 U.S. 460, 470-71 (1965) (implying that neither Congress nor federal courts can formulate substantive rules in guise of providing procedural rules for federal courts). See *Daily Income Fund, Inc. v. Fox*, 104 S. Ct. 831, 842 (1984) (Stevens, J., concurring); *Weiss v. Temporary Inv. Fund, Inc.*, 692 F.2d 928, 946 (3d Cir. 1982) (Gibbons, J., dissenting on other grounds).

A similar question has been raised regarding the validity of the "contemporary ownership" requirement of Rule 23.1. See 7A C. WRIGHT & A. MILLER, *supra* note 84, at § 1829; 3B J. MOORE & J. KENNEDY, *MOORE'S FEDERAL PRACTICE* ¶ 23.1.15 (2d ed. 1982); see also *Smith v. Sperling*, 354 U.S. 91, 95 (1957) (local law governs in stockholder derivative actions). Professor Kessler in 1973 proposed an amendment of the Rule to require contemporary ownership only "if necessary under the law of the forum state." See Kessler, *Shareholder Derivative Actions: A Modest Proposal to Revise Federal Rule 23.1*, 7 J. LAW REF. 90, 91 (1973). In his view, such an amendment not only was consistent with *Erie R. R. v. Tompkins*, 304 U.S. 64 (1938), but perhaps was constitutionally required to save Rule 23.1. Kessler, *supra*, at 91. By "law of the forum state," Kessler apparently meant to include also the choice-of-law rules of the forum. *Id.* at 118 n.99.

92. For a discussion of freezeouts, see Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CALIF. L. REV. 1073, 1115-18 (1983); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 307-13 (1974); Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 705-08 (1982). Also of interest is a recent short but thoughtful piece by SEC Commissioner Longstreth, *Fairness of Management Buyouts Needs Evaluation*, Legal Times, Oct. 10, 1983, at 15, col. 1 (arguing that market forces rather than court intervention should be maximized to protect small shareholders); see also Malenbaum, *Helping a Company Go Private*, Nat'l L. J., Jan. 16, 1984, at 15, col. 2 (discussing benefits and legal formalities of going private).

93. See *Weinberger v. United Fin. Corp.*, 457 A.2d 701 (Del. 1983); *Singer v. Magnavox*, 380 A.2d 969 (Del. 1977); *Tanzer v. International Gen. Indus.*, 379 A.2d 1121 (Del. 1977).

94. See, e.g., *Mullen v. Academy Life Ins. Co.*, 705 F.2d 971, 972-73 (8th Cir. 1983) (New Jersey corporation; New Jersey law governs short-form merger freezeout; "fairness" of price determined other than through appraisal); *Shivers v. Amerco*, 670 F.2d 825, 832 n.3 (9th Cir. 1982) (100:1 reverse stock split; destruction of market in stock; fiduciary duty of majority governed by law of incorporation state—Nevada); *Dower v. Mosser Indus., Inc.*, 648 F.2d 183, 188-89 (3d Cir. 1981) (Pennsylvania corporation; Pennsylvania law on fiduciary duty of controlling parent in freezeout merger); *Coleman v. Taub*, 638 F.2d 628, 629 n.1 (3d Cir. 1981) (corporate law of Delaware governs effect of buyout contract on fiduciary duties of directors in freezeout merger); *Bryan v. Brock & Blevins Co.*, 490 F.2d 563, 571 (5th Cir.) (freezeout merger; Georgia law applied where company was incorporated and had its principal place of business there), *cert. denied*, 419 U.S. 844 (1974);

e. *Other issues.* The law of the state of incorporation has also been applied, either automatically or with a cursory justification, to a great many other internal affairs issues. These include: fiduciary duties of management⁹⁵ or of controlling shareholders⁹⁶ (including duties related to securities trading),⁹⁷ sale of control,⁹⁸ indemnification of manage-

Tanzer v. Turbodyne Corp., 68 A.D.2d 614, 618, 417 N.Y.S.2d 706, 710 (1981) (cashout merger challenged on fraud and inadequate price; Delaware corporate law applied).

95. See, e.g., Cowin v. Brester, 741 F.2d 410, 414 n.3 (D.C. Cir. 1984) (manipulation of business by management for personal profit; applied law of incorporation state—Delaware); Gregg v. U.S. Indus., Inc., 715 F.2d 1522, 1537 (11th Cir. 1983) (New York conflicts rule; Delaware law regarding declared dividends); Walton v. Morgan Stanley, Inc., 623 F.2d 796, 798 n.3 (2d Cir. 1980) (takeover conflict; disclosure of confidential information obtained from target; New York conflicts rule “dictates” law of state of incorporation); Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980) (Pennsylvania conflicts rule; Delaware law on waste in issuing stock), *cert. denied*, 450 U.S. 999 (1981); Miller v. AT&T, 507 F.2d 759, 761-63 (3d Cir. 1974) (New York law on fiduciary duties of directors); Polon v. Huffines, 446 F.2d 384, 386 n.6 (7th Cir. 1971) (breach of duty in causing corporation to buy overvalued stock in another company for “bail-out” of defendants; Ohio law); Republic Systems & Programming, Inc. v. Computer Assistance, Inc., 440 F.2d 996, 997 (2d Cir. 1971) (Medina, J., dissenting) (fiduciary obligations and tenure of officers; illogical to vary them with location; apply law of state of incorporation—Texas); Perlman v. Feldmann, 219 F.2d 173, 175 (2d Cir. 1955) (New York conflicts rule; Indiana law on sale of control); Burton v. Exxon Corp., 583 F. Supp. 405, 414 (S.D.N.Y. 1984) (declaration of dividends on preferred stock favoring parent company; New York conflicts rule apply law of state of incorporation—Delaware); Massaro v. Vernitron Corp., 559 F. Supp. 1068, 1080 (D. Mass. 1983) (Massachusetts conflicts rule; Delaware law on liability for misrepresentations involving products, even though principal place of business in New York); B. J. McAdams, Inc. v. Boggs, 439 F. Supp. 738, 743 (E.D. Pa. 1977) (Pennsylvania conflicts rule; Arkansas state of incorporation as well as principal place of business, headquarters, place of employment); Lachman v. Bell, 353 F. Supp. 37, 39-40 (S.D.N.Y. 1972) (New York conflicts rule; Delaware law on fiduciary duties relating to share transactions); Singer v. Creole Petroleum, 297 A.2d 440, 443 (Del. Ch. 1972) (Delaware law); Sinclair Oil v. Levien, 280 A.2d 717, 719 (Del. 1971) (Delaware law).

96. See, e.g., Lewis v. Knutson, 699 F.2d 230, 239 (5th Cir. 1983) (Texas conflicts rule; Delaware law controls even though principal place of business in Texas); Zahn v. Transamerica Corp., 162 F.2d 36, 40 (3d Cir. 1947) (Delaware conflicts; duty of controlling parent to minority shareholders involving redemption and conversion of stock; existence and scope of duty subject to law of state of incorporation; “quantum” of breach subject to *lex loci delicti*); *In re Reading Co.*, 551 F. Supp. 1205, 1214 n.2 (E.D. Pa. 1982) (Pennsylvania conflicts rule; Delaware law on duty to minority involving self-dealing and sale of control; parties stipulated); Speed v. Transamerica Corp., 135 F. Supp. 176, 198 (D. Del. 1955) (referring to law of incorporation—Kentucky—for all issues, including “quantum”), *aff’d as modified*, 235 F.2d 369 (3d Cir. 1956); *cf.* Haberman v. Tobin, 446 F. Supp. 447, 449-50 (S.D.N.Y. 1979) (New York conflicts; proxy rule violations in context of tender offer; for statute of limitations purposes, claim accrues where actions took place, not at state of incorporation).

97. See, e.g., Thomas v. Roblin Indus., 520 F.2d 1393, 1397 (3d Cir. 1975) (Pennsylvania conflicts rule; Delaware law on misuse of inside information by controlling shareholders); Schein v. Chasen, 478 F.2d 817, 820 n.3 (2d Cir. 1973) (parties agreed that Florida law applied regarding disgorgement of profits from trading on inside information); Sanders v. Thrall Car Mfg. Co., FED. SEC. L. REP. (CCH) ¶ 99,500, at 96,918 (S.D.N.Y. 1983) (trading on inside information, manipulating price of stock in context of tender offer; parties agreed on law of incorporation state—Iowa); Diamond v. Oreamuuo, 24 N.Y.2d 494, 503-04, 248 N.E.2d 910, 915, 301 N.Y.S.2d 78, 85 (1969) (law of incorporation state—New York—remains primary source).

ment,⁹⁹ business judgment,¹⁰⁰ delegation of management functions,¹⁰¹ shareholder meetings,¹⁰² inspection of shareholder lists,¹⁰³ shareholder agreements,¹⁰⁴ issuance of securities,¹⁰⁵ stock transfer restrictions,¹⁰⁶ capital impairment,¹⁰⁷ dividends,¹⁰⁸ requirements for mergers,¹⁰⁹ sales of as-

98. See, e.g., *Haberman v. Murchison*, 468 F.2d 1305, 1314 (2d Cir. 1972) (sale of shares at premium reflecting transfer of control; "it is not controverted that the governing law . . . is the law of Maryland [state of incorporation]"); *Perlman v. Feldmann*, 219 F.2d 173, 175 (2d Cir. 1955) (New York conflicts rule; sale of control subject to law where incorporated—Indiana).

99. See, e.g., *Davist Cox v. Summa*, 751 F.2d 1507, 1527 (9th Cir. 1985) (indemnification rights involve issues peculiar to the affairs of corporations; governed by law of incorporation—Delaware); *Gross v. Texas Plastics, Inc.*, 344 F. Supp. 564, 566 n.2 (D.N.J. 1972) (law of state of incorporation—Texas—applies; states have no interest in regulating internal affairs of foreign corporations; by-laws are contracts between corporation and shareholders, therefore construction governed by law of place where made).

100. See, e.g., *Clark v. Lomas & Nettleton Fin. Corp.*, 625 F.2d 49, 52 n.3 (5th Cir. 1980) (settlement by directors of proxy violation claim; law of incorporation—Texas—applies "in absence of any contrary suggestion by either party").

101. See, e.g., *Long Park v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 180-82, 77 N.E.2d 633, 635-36 (1948) (Fuld, J., dissenting) (management agreement violates law of incorporation—New Jersey—as well as that of New York, where made).

102. See, e.g., *Fairmont Foods Co. v. Manganello*, 301 F. Supp. 832, 835 (S.D.N.Y. 1969) (New York conflicts rule; Ontario incorporation law governs enforcement of voting agreement and shareholders meetings; however, "sale of vote" in New York requires application of New York law if contract made in New York, under "contacts" and "intimate concern" theories); *Lerman v. Diagnostic Data, Inc.*, 421 A.2d 906, 907 (Del. Ch. 1980) (Delaware law governs meeting dates).

103. See, e.g., *Caspary v. Louisiana Land & Exploration Co.*, 707 F.2d 785, 786, 788 (4th Cir. 1983) (Maryland law, where it is law of incorporation state, governs percentage requirements.).

104. See, e.g., *Zion v. Kurtz*, 50 N.Y.2d 92, 101-02, 405 N.E.2d 681, 684, 428 N.Y.S.2d 199, 203 (1980) (major New York case applying Delaware law to Delaware corporation, involving agreement limiting corporate activities).

105. See, e.g., *Beard v. Elster*, 160 A.2d 731, 735 (Del. 1960) (validity of issuance of options involves corporate internal affairs, it is not a contract question and is governed by law of incorporation state); *Elster v. American Airlines*, 100 A.2d 219, 225 (Del. Ch. 1958) (by acquiring stock, shareholders consent to application of law of state of incorporation). Cf. U.C.C. § 8-106 (1977): The validity of a security and the rights and duties of the issues with respect to registration of transfer are governed by the law (including the conflict of laws rules) of the jurisdiction of the organization of the issuer.

106. See, e.g., *B & H Warehouse v. Atlas Van Lines*, 490 F.2d 818, 821 (5th Cir. 1974) ("validity of any restriction is to be determined according to the law of the state of incorporation"); cf. *Kerrigan v. Merrill Lynch*, 450 F. Supp. 639, 644 n.5 (S.D.N.Y. 1978) (applying law of incorporation state because plaintiffs asserted no rights under any other law); *St. Louis v. Merrill Lynch*, 412 F. Supp. 45, 56 (E.D. Mo. 1976).

107. See, e.g., *Libco Corp. v. Leigh*, 703 F.2d 996, 1000 n.3 (7th Cir. 1983) (acquisition of stock by corporation impairing capital).

108. See, e.g., *Kroese v. General Steel Castings Corp.*, 179 F.2d 760, 765 (3d Cir. 1950) (Pennsylvania conflicts rule; Delaware law on preferred dividends); *Kern v. Chicago & E. Ill. R.R.*, 6 Ill. App. 3d 247, 250, 285 N.E.2d 501, 503 (1972) (Illinois conflicts rule; Indiana law on preferred dividends).

109. See, e.g., *Susinan v. Lincoln Ave. Life Ins.*, 16 SEC. REG. & L. REP. (BNA) No. 2, at 225, 226 (N.D. Ill. Jan. 9, 1984); *Seibert v. Milton Bradley Co.*, 380 Mass. 656, 657, 405 N.E.2d 131, 132 (1980) (Massachusetts law); *Seibert v. Gulton Indus., Inc.*, No. 5631, slip op. at 3 (Del. Ch. June 21, 1979) (Delaware law), *aff'd*, 414 A.2d 822 (Del. 1980).

sets,¹¹⁰ acquisitions,¹¹¹ and recapitalizations.¹¹²

B. *Statutory Support for the Rule of Lex Incorporationis.*

It is remarkable and puzzling that neither the courts nor the commentators show any awareness of the fact that many state statutes contain explicit language limiting the applicability of their law solely to corporations organized under their statute, thereby adopting a unilateral *lex incorporationis* rule. For example, section 1701.98 of the Ohio General Corporation law provides that: "Except as [otherwise] provided in Sections 1701.01 to 1701.98, inclusive, of the Revised Code *the provisions of said Sections shall apply only to domestic corporations . . .*"¹¹³ Section 1701(A) defines domestic corporations as corporations "for profit formed under the laws of this state." Yet in a case just decided, the Supreme Court of Ohio applied the Ohio statute to validate a shareholder agreement of a Delaware corporation, on a "most significant relationship" theory, because the agreement and the shareholders had major Ohio contacts. Neither the majority nor the dissent referred to section 1701.98, which would have prevented application of Ohio law, or to section 1701.49(G), which would have arguably invalidated it if the agreement were deemed to be an Ohio voting trust..¹¹⁴

In the new Business Corporation Act of Minnesota, the key word "corporation" is defined as "a corporation, other than a foreign corporation, . . . incorporated under or governed by this chapter"; "foreign corporation" means "a corporation . . . incorporated under laws other than the laws of this state. . . ." ¹¹⁵ The Pennsylvania statute applies to all

110. See, e.g., *Great W. Producers Corp. v. Great W. United Corp.*, 200 Colo. 180, 182 n.2, 613 P.2d 873, 875 n.2 (1980).

111. See, e.g., *Jordan v. Global Natural Resources, Inc.*, 564 F. Supp. 59, 62 n.1 (S.D. Ohio 1983) (English law regarding shareholder approval of acquisition by acquiring company).

112. See, e.g., *O'Brien v. Virginia-Carolina Chem. Corp.*, 44 N.J. 25, 39, 206 A.2d 878, 885 (1965) (effect of recapitalization on preferred dividend arrearage), *cert. denied*, 389 U.S. 825 (1967).

113. OHIO REV. CODE ANN. § 1701.98 (Page 1978) (emphasis supplied). Only a few sections fall within the exception. For examples, see, section 1701.13(H) (Ohio limitations on ultra vires defense apply to foreign corporations if contract was made in the state) and section 1701.49(G) (shares of foreign corporation may be subject to an Ohio voting trust). The sections dealing with mergers require that the transaction comply with the laws of the states of incorporation of each corporation. OHIO REV. CODE ANN. §§ 1701.78(A), (B)(1), (B)(4), 1701.79(A), (B)(1), (C) & (F) (Page 1978). Dissenters' rights are granted only to shareholders of the domestic corporations. OHIO REV. CODE ANN. §§ 1701.84, 1701.85 (Page 1978).

Quo warranto actions are not available to oust officers of foreign corporations. OHIO REV. CODE ANN. § 2733.01(A) (Page 1981). In *State ex rel. Corrigan v. Great Northern-Chan Restaurant*, 3 Ohio App. 3d 355, 357, 445 N.E.2d 732, 733-34 (1982), the court referred to the *lex incorporationis* as the quo warranto rule prevailing in Ohio.

114. *Gries Sports Enterprises v. Modell*, 15 Ohio St. 3d 284 (1984).

115. MINN. STAT. ANN. § 302A.011(8), (12) (West 1985). Under prior Minnesota law the definitions were not as clear. See MINN. STAT. ANN. § 300.02(2), (5), (6) (West 1969). In 1983, Minn-

"domestic corporations"—i.e., those that are "incorporated or domesticated in this Commonwealth."¹¹⁶ A "foreign business corporation" is one "incorporated under any laws other than those of this Commonwealth."¹¹⁷ A foreign corporation may "domesticate" by filing for local incorporation and renouncing its original incorporation.¹¹⁸ Only in certain rare instances—such as the ultra vires defense against contracts and conveyances in Pennsylvania, or cases involving local property—does the Pennsylvania act apply to foreign corporations.¹¹⁹

The lex incorporationis rule also finds statutory support in section 106 of the Model Business Corporation Act (MBCA), adopted in many states, which provides that:

*A foreign corporation shall not be denied a certificate of authority by reason of the fact that the laws of the state or country under which such corporation is organized governing its organization and internal affairs differ from the laws of this state, and nothing in this Act contained shall be construed to authorize this state to regulate the organization or the internal affairs of such corporations.*¹²⁰

This section conveys a clear message. First, it assumes that the law of the state of incorporation "governs" corporate organization and internal affairs. Second, it disclaims any intention to intervene in such affairs.¹²¹

In Texas, the language in section 106 on "internal affairs"—not organization—is qualified by the words "not intrastate in Texas."¹²² It has been suggested that this cryptic variation invites the courts to develop

sota also adopted a separate "Foreign Corporation Act" which regulates the conditions of doing intrastate business in Minnesota. See MINN. STAT. ANN. §§ 303.01-303.25 (West 1984).

116. PA. STAT. ANN. tit. 15, § 1002(6) (Purdon 1967 & Supp. 1984).

117. PA. STAT. ANN. tit. 15, § 1002(8) (Purdon 1967 & Supp. 1984).

118. PA. STAT. ANN. tit. 15, § 1909 (Purdon 1967 & Supp. 1984).

119. PA. STAT. ANN. tit. 15 § 1303(c) (Purdon 1967). Other examples abound. The Florida statute provides that "unless the context otherwise requires, the term . . . 'corporation' . . . means a corporation subject to the provisions of [the Florida General Corporation Act] except a foreign corporation." FLA. STAT. ANN. § 607.004 (West 1977). See also *Padovano v. Wotitzky*, 355 So.2d 873 (Fla. Dist. Ct. App. 1978). Similar language is also used in the South Dakota Corporation Law. S.D. CODIFIED LAWS ANN. § 47-2-1(1) (1983). See also *Cargill, Inc. v. American Pork Prod.*, 415 F. Supp. 876, 878-79 (D.S.D. 1978). Most "internal affairs" sections of the Corporation Law of Hawaii are addressed only to corporations "created" or "incorporated" or "organized" under the law of Hawaii or to "domestic" corporations. HAWAII REV. STAT. §§ 416-32, 416-51, 416-58, 416-59, 416-64, 416-75 (1976 & Supp. 1983).

120. MODEL BUSINESS CORP. ACT ANN. § 106 (1971) (emphasis added).

121. See *Preface*, MODEL BUSINESS CORP. ACT (1953 rev.), at xi. Comment 4 to the 1964 version of § 99, the predecessor to § 106, which somewhat diluted its import by clarifying that while no power to regulate was conferred there was no preclusion either, MODEL BUSINESS CORP. ACT ANN. § 99 comment 4 (1960 & Supp. 1966); that comment has been dropped from § 106. Comment 2 now contains only some general language on the lack of visitorial powers over foreign corporations as a matter of jurisdiction and refers to possible exceptions based on convenience, expediency, public policy, and substantial justice. MODEL BUSINESS CORP. ACT ANN. § 106 comment 2 (1971).

122. TEX. STAT. ANN. art. 8.01(A) (Vernon 1980).

appropriate exceptions to the *lex incorporationis* rule,¹²³ but there is no indication that such invitation has ever been accepted. Texas also subjects foreign corporations to the Texas law pertaining to the duties, restrictions, penalties, and liabilities of corporate directors and officers but only as to "matters affecting the transaction of intrastate business in this State."¹²⁴ The only case to consider the meaning of this language is *Maher v. Zapata Corp.*,¹²⁵ which involved the liability of corporate fiduciaries of a Texas-headquartered Delaware corporation for loans made to officers in Texas to enable them to exercise certain stock options. The Court of Appeals for the Fifth Circuit held that such loans were subject to Delaware law, which permitted the loans, rather than to Texas law, which made them *ultra vires*.¹²⁶ The court ruled that the internal affairs aspects of such loans, as distinguished from questions relating to the rights of third parties, continue to be subject to the law of incorporation, at least where the company is not purely local.¹²⁷ This constitutes an extraordinarily strong reaffirmation of the *lex incorporationis* in the face of an ambiguous state statute.¹²⁸

A new Revised Model Business Corporation Act was approved in June 1984, and is intended to replace the current one. The official commentary to section 15.05 reiterates and reinforces the non-interference language appearing in the present section 106 by explaining that section 15.05(c) "preserves the judicially developed doctrine that internal corporate affairs are governed by the state of incorporation even when the corporation's business and assets are located primarily in other states."¹²⁹

123. See Latty, *Some Miscellaneous Novelties in the New Corporation Statutes*, 23 LAW & CONTEMP. PROBS. 363, 397-98 (1958) (questioning whether directors of foreign corporation would be liable under this language if they hold meetings in Texas and declare dividend that would be illegal for Texas corporation but not under law of state of incorporation).

124. TEX. STAT. ANN. art. 8.02(A) (Vernon 1980).

125. 714 F.2d 436 (5th Cir. 1983).

126. *Id.* at 439.

127. *Id.* at 441.

128. In support of the *lex incorporationis*, the court cited several old Texas cases, the Supreme Court cases of *Rogers v. Guaranty Trust Co.*, 288 U.S. 123, 130 (1933), and *Broderick v. Rosner*, 294 U.S. 629, 643-44 (1935), and RESTATEMENT (SECOND), *supra* note 46, § 302. *Maher*, 714 F.2d at 464. The court distinguished its own celebrated precedent of *Mansfield Hardwood Lumber Co. v. Johnson*, 268 F. 2d 317, 321 (5th Cir.), *cert. denied*, 361 U.S. 885 (1959), as involving a pseudo-foreign corporation and largely an external affairs issue. *Id.* at 465.

In an earlier case decided by a different panel of the same court, *Meyers v. Moody*, 693 F.2d 1196 (5th Cir. 1982), *cert. denied*, 104 S. Ct. 287 (1983) (involving a multistate corporation and multistate transactions), there are dicta that sections 8.01 and 8.02 of the Texas statute call for the application of Texas law to the duty of care of officers and directors of "foreign corporations doing business in the state" without reference to intrastate business. 693 F.2d at 1209. The holding in *Meyers* is of limited significance because it is based on a specific provision which calls for the application of the law of Texas to insurance companies doing business in Texas. See 693 F.2d at 1208.

129. REVISED MODEL BUSINESS CORP. ACT § 15.05(c) (1984).

The discussion of the MBCA would not be complete without reference to section 107, entitled "Powers of Foreign Corporations," which provides that a qualified foreign corporation enjoys rights and privileges which are the same as, and no greater than, those enjoyed by a domestic corporation, and is subject to the same duties, restrictions, penalties, and liabilities. This section was intended to grant foreign corporations "a status of substantial equality with like domestic corporations insofar as permissible corporate powers are concerned,"¹³⁰ not to authorize back-door interference in their internal affairs.¹³¹ This can also be seen in the Revised Model Business Corporation Act's section 15.05(b),¹³² which replaces current section 107. The comments clearly indicate that it is not its purpose to subject internal affairs matters to local law.¹³³

In their proposal to amend section 49 of the Model Business Corporation Act to include explicit rules on the termination of derivative litigation, Professors Coffee and Schwartz also choose the law of the state of incorporation. They do recognize that the forum state may decide to override it, but only through an express and specific statute and only

130. 2 MODEL BUSINESS CORP. ACT ANN. § 107 comment 2 (1971).

131. There is, however, some ambiguous authority suggesting otherwise. In *Houck v. Martin*, 82 Ill. App. 3d 205, 402 N.E.2d 421 (1980), there are dicta to the effect that the Illinois equivalent of § 107—ILL. REV. STAT. ch. 32, § 157.103 (Smith-Hurd 1970)—applies the Illinois prohibitions against loans to officers and directors to a Delaware corporation with some Illinois contacts. The court did not analyze or weigh the multistate contacts and did not offer any explanation or justification for its interpretation other than to cite *Vinylwed, Inc. v. Metropolitan Greetings, Inc.*, 360 F. Supp. 1360 (N.D. Ill. 1973), *aff'd*, 519 F.2d 1406 (7th Cir. 1974). This citation is puzzling because *Vinylwed* dealt with an entirely different issue—the conditions under which the property of a foreign corporation is subject to attachment. The *Houck* court must have been concerned with the protection of creditors in bankruptcy in an external affairs context. This explanation is supported by concurring Judge Green's clarification that § 107 does not place "all of the same restrictions on foreign corporations doing business in Illinois as upon domestic corporations when the *internal* affairs of the corporation are involved." *Houck v. Martin*, 82 Ill. App. 3d at 216, 402 N.E.2d at 429-30 (Green, J., concurring). Cf. *Katz, The Illinois Business Corporation Act*, 12 WIS. L. REV. 472, 482-84 (1937). The *Houck* approach stands in direct contrast to the limiting position taken in *Maier v. Zapata*, 714 F.2d 436, 439-41 (5th Cir. 1983). See *supra* notes 125-28 and accompanying text. But some support for the decision can be found in certain older cases applying Illinois law to the inspection rights of shareholders of foreign corporations on the theory that this is a reasonable condition of doing business in Illinois. See *McCormick v. Statler Hotels Delaware Corp.*, 30 Ill. 2d 86, 89, 195 N.E.2d 172, 174-75 (1963). The court in *Kahn v. American Cone & Pretzel Co.*, 365 Pa. 161, 74 A.2d 160 (1950), read the stronger language contained in PA. CONS. STAT. ANN. § 2010 (Purdon 1967) ("to the same extent as if it had been incorporated under this act to transact the business set forth in its certificate of authority"), to impose on qualified foreign corporations the Pennsylvania rules on inspection of shareholder lists under § 308(A). The court apparently ignored the fact that § 308(A) applies only to "business corporations," which are defined in § 2(6) not to include foreign corporations. See also *supra* note 116 and accompanying text.

132. REVISED MODEL BUSINESS CORP. ACT § 15.05(b) (1984).

133. REVISED MODEL BUSINESS CORP. ACT § 15.05 commentary at 15.20 (1984).

when the corporation has major contacts with the state.¹³⁴

In addition, the Revised Uniform Limited Partnership Act of 1976,¹³⁵ which is gradually replacing the old ULPA, adopts more clearly than any other piece of legislation the *lex incorporationis* as a conflicts rule, rather than merely as a unilateral presumption or assumption of non-interference:

Section 901 [Law governing].

Subject to the Constitution of this State, (1) the laws of the state under which a foreign limited partnership is organized govern its organization and internal affairs and the liability of its limited partners and (2) [it] may not be denied registration by reason of any difference between those laws and the laws of this state."¹³⁶

Finally, there are many instances where federal law assumes and reinforces the applicability of the law of incorporation. For example, Rule 14a-8(c)(1),¹³⁷ promulgated by the SEC under section 14(a) of the Securities and Exchange Act of 1934,¹³⁸ enables corporations to exclude from their proxy statements any shareholder proposal that is, "under the laws of the issuer's domicile, not a proper subject for action by security holders."¹³⁹ In addition, Rule 17(b) of the Federal Rules of Civil Procedure, now duplicated in many states, looks to the law of the state of incorporation to determine the capacity of the corporation to sue or be sued and the authority of the directors to institute suit.

V. THE CONSTITUTIONAL UNDERPINNINGS OF THE LEX INCORPORATIONIS: FROM FULL FAITH AND CREDIT TO THE COMMERCE CLAUSE

A. *Choice of Law and the Constitution.*

There was a time when the Supreme Court drew heavily on full faith and credit and, to a lesser extent, due process in order to determine the

134. See Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 332-33 (1981).

135. REVISED UNIF. LIMITED PARTNERSHIP ACT (1976), 6 U.L.A. 189 (Supp. 1984).

136. *Id.* at § 901, 6 U.L.A. at 244.

137. 17 C.F.R. § 240.14a-8(c)(1) (1984).

138. 15 U.S.C. § 78n(a) (1982).

139. 17 C.F.R. § 240.14a-8(c)(1) (1984). The term "laws of the issuer's domicile" means the law of the state of incorporation. See, e.g., SEC v. Transamerica, 163 F.2d 511, 518 (3d Cir. 1947) (in determining whether proposals were proper subjects for action by securities holders, court applied law of state of incorporation); Ouellette v. Sturm, Ruger & Co., 466 A.2d 478, 481 (Me. 1983) ("It has long been established that a corporation is a resident of that state in which it is incorporated."). See also 17 C.F.R. § 240.36-4(c) (1984) (distinguishes between domestic and foreign corporations on basis of their place of incorporation).

basic conflicts choices.¹⁴⁰ This coincided with the heyday of conflicts territorialism and the use of single, neutral, event-related connecting factors—such as place of the wrong—to select one proper law, regardless of forum, to govern particular transactions and relations.¹⁴¹ Among the rules deemed to have some constitutional underpinnings was the rule applying the law of the state of incorporation to the internal affairs of corporations.¹⁴²

A countertrend began as early as 1935 when, in *Alaska Packers Association v. Industrial Accident Commission*,¹⁴³ Justice Stone watered down the full faith and credit obligation. That case held that, prima facie, a state is entitled to enforce its statutes in its own courts; whoever makes a full faith and credit claim has the burden of showing that the conflicting interests of another state are superior to those of the forum.¹⁴⁴ The increasing deference given by the federal courts to state law after *Erie Railroad v. Tompkins*¹⁴⁵ and *Klaxon Co. v. Stentor Electric Manufacturing*¹⁴⁶ should have accentuated the full faith and credit obligation; instead, the *Alaska Packers* rationale continued to expand to the point that if a state were able to justify the applicability of its law under due process on the basis of some local contacts, it was no longer required to give any credit to the conflicting laws of other states.¹⁴⁷ The constitu-

140. See, e.g., *New York Life Ins. Co. v. Dodge*, 256 U.S. 357 (1918); *Bradford Electric Light Co. v. Clapper*, 286 U.S. 145 (1932); *Hartford Accident & Indem. Co. v. Delta Pine Land Co.*, 292 U.S. 143 (1934); *John Hancock Mutual Life Ins. Co. v. Yates*, 299 U.S. 178 (1936). See also Cheatham, *Federal Control of Conflict of Laws*, 6 VAND. L. REV. 581 (1953); Dodd, *The Power of the Supreme Court to Review State Decisions in the Field of Conflict of Laws*, 39 HARV. L. REV. 533 (1926); Ross, *Has the Conflict of Laws Become a Branch of Constitutional Law?*, 15 MINN. L. REV. 161 (1931).

141. The FIRST RESTATEMENT, *supra* note 45, the embodiment of the traditional conflicts approaches, was adopted in 1934 after eleven years of preparation under the leadership of Professor Beale. At least until the sixties, its influence on state practice was widespread and pervasive.

142. See, e.g., *Broderick v. Rosner*, 294 U.S. 629, 643 (1935) (application of law of state of incorporation to contractual liability of stockholders for tax assessments is supported by full faith and credit clause); *Converse v. Hamilton*, 224 U.S. 243, 256-57 (1912) (full faith and credit clause provides right of receiver to sue in state other than that of incorporation to recover double liability imposed on stockholders, and courts of that state are bound to give full faith and credit to laws of state of incorporation).

143. 294 U.S. 532 (1935).

144. *Id.* at 547.

145. 304 U.S. 64 (1938).

146. 313 U.S. 487 (1941).

147. See, e.g., *Clay v. Sun Ins. Office, Ltd.*, 377 U.S. 179, 181-82 (1964); *Richards v. United States*, 369 U.S. 1, 10 (1962); *Carroll v. Lanza*, 349 U.S. 408, 412-13 (1955); see also Kirgis, *The Roles of Due Process and Full Faith and Credit in Choice of Law*, 62 CORNELL L. REV. 94, 102-10 (1976); Martin, *Constitutional Limitations on Choice of Law*, 61 CORNELL L. REV. 185, 186-201 (1976); Reese, *Legislative Jurisdiction*, 78 COLUM. L. REV. 1587, 1589-94 (1978); Weintraub, *Due Process and Full Faith and Credit Limitations on a State's Choice of Law*, 44 IOWA L. REV. 449 (1959).

tional quest for the *most* appropriate law was thus abandoned.

Whatever restraints existed under due process were further lessened in the recent case of *Allstate Insurance Co. v. Hague*¹⁴⁸ in which the plurality of the Supreme Court held that *any* "significant" contact or aggregation of contacts generating state interests satisfies due process and dispenses with the full faith and credit obligation.¹⁴⁹ This test is vague enough and flexible enough to accept virtually any claim of interest. Some hope for the development of reasonable limitations may be found in the fact that the *Allstate* result has been criticized on the ground that the Minnesota contacts in that case were trivial or specious and bore no appropriate relationship to the state interests asserted.¹⁵⁰ Nevertheless, it must be conceded that *Allstate* lends some constitutional legitimacy to the proliferating new conflicts theories that, despite their doctrinal and methodological differences, encourage the maximum application of forum law—especially if it also favors forum residents, as it did in *Allstate*.¹⁵¹

148. 449 U.S. 302 (1981).

149. *Id.* at 312-13. The dissent apparently agreed with the plurality on this issue. *Id.* at 332 (Powell, J., dissenting).

150. See Kozyris, *Reflections on Allstate—The Lessening of Due Process in Choice of Law*, 14 U.C.D. L. REV. 889, 897-903 (1981). See also Brilmayer, *Legitimate Interests in Multistate Problems: As Between State and Federal Law*, 79 MICH. L. REV. 1315, 1341-49 (1981); Hill, *Choice of Law and Jurisdiction in the Supreme Court*, 81 COLUM. L. REV. 960, 968-74 (1981).

The precedential value of *Allstate*—decided by a plurality of four against three—is diminished not only because of its questionable application of the "significant contacts" test but also by the nature of its subject matter. The tendency to give insurance policyholders all possible advantages, including the benefit of any favorable law, is well known. Cf. Martin, *The Constitution and Legislative Jurisdiction*, 10 HOFSTRA L. REV. 133, 148 n.6 (1982) (traditionally insurance companies get "short end of the stick" in difficult choice-of-law issues). Furthermore, it appears that the Supreme Court was concerned that a reversal would have opened the floodgates of conflicts litigation. See Silberman, *Can the State of Minnesota Bind the Nation? Federal Choice of Law Constraints After Allstate Insurance Co. v. Hague*, 10 HOFSTRA L. REV. 103, 104 n.6 (1982); von Mehren & Trautman, *Constitutional Control on Choice of Law: Some Reflections on Hague*, 10 HOFSTRA L. REV. 35, 37-38 (1982). But as Professors von Mehren and Trautman persuasively demonstrate, *Allstate* could have been reversed under a principle against state overreaching that would not have brought about a nightmare of litigation.

151. For examples of these theories, see B. CURRIE, *On the Displacement of the Law of the Forum*, in SELECTED ESSAYS ON THE CONFLICT OF LAWS 61 (1963) [hereinafter cited as SELECTED ESSAYS]; R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 346 (1980); Leflar, *Choice of Law: States' Rights*, 10 HOFSTRA L. REV. 203, 207-08 (1982); Reese, *American Trends in Private International Law: Academic and Judicial Manipulation of Choice of Law Rules in Tort Cases*, 33 VAND. L. REV. 717, 734-37 (1980); Silberman, *supra* note 150, at 112, 114; Sedler, *Constitutional Limitations on Choice of Law: The Perspective of Constitutional Generalism*, 10 HOFSTRA L. REV. 59, 73 (1982); von Mehren & Trautman, *supra* note 150, at 49-50.

B. *Choice of Law for Corporate Internal Affairs Under Full Faith and Credit and Due Process.*

Does the attenuation of full faith and credit and due process mean that the rule of *lex incorporationis* has lost its constitutional underpinnings and now is at most a conflicts rule? May the states instead apply their own internal affairs law to foreign corporations on the basis of some "significant" contacts generating state interests in the corporation, in particular parties, or in transactions? More specifically, what is the current status of *Order of United Commercial Travellers v. Wolfe*,¹⁵² the last Supreme Court case to mandate, under full faith and credit, the application of any law which happened to be the law of the state of incorporation?

Even before *Allstate*, the authority of *Wolfe* was in some doubt.¹⁵³ Not only was its persuasiveness questioned (as a five-to-four decision), but it was also viewed as the last of a line of now-discredited cases that sought to constitutionalize choice of law.¹⁵⁴ The dicta in *Shaffer v. Heitner*,¹⁵⁵ a landmark jurisdictional case, on the applicability of the law of the state of incorporation to internal corporate affairs did not even mention *Wolfe*.¹⁵⁶ Instead, the Court referred to *Koster v. Lumbermans Mutual Casualty Co.*,¹⁵⁷ an older forum non conveniens case, to support the proposition that there is a need for a uniform and certain standard to govern internal corporate affairs.¹⁵⁸

Some commentators have argued that, despite its general language, *Wolfe* is limited to the narrow category of fraternal societies and does not extend to commercial corporations.¹⁵⁹ Nothing in the language of *Wolfe* supports the proposed limitation. On the contrary, the *Wolfe* dissenters

152. 331 U.S. 586 (1947).

153. See Reese & Kaufman, *supra* note 1, at 1131 n.53. Professor Currie did not address the merits of the *Wolfe* choice but criticized it and the earlier fraternal insurance cases on the ground that the Supreme Court should not engage in the political function of becoming an arbiter of state interests and should not prevent the application of the law of any interested state in order to give preference to another law. See also B. CURRIE, *The Constitution and Choice of Law*, in SELECTED ESSAYS, *supra* note 151, at 188, 253-59. If in a particular field there is a need for national uniformity or for the application of a single state law, he argued, let Congress legislate the choice. *Id.* at 271-82.

154. See Cheatham, *supra* note 140, at 596 ("With the Supreme Court of the United States so divided in opinion, it is uncertain to what extent the supposed old special rule as to fraternal insurance companies will be followed.").

155. 433 U.S. 186 (1977).

156. *Id.* at 215 n.44, 225-27.

157. 330 U.S. 518 (1947).

158. *Shaffer*, 433 U.S. at 215 n.44.

159. See Baraf, *supra* note 54, at 244; Kaplan, *supra* note 1, at 445-47. Cf. *Clay v. Sun Ins. Office Ltd.*, 377 U.S. 179, 183 (1964) (*Wolfe* is a "highly specialized decision dealing with unique facts . . . involving the 'indivisible unity' of the fraternal society. . . . We do not extend that rule nor apply it [in workmen's compensation context]."). See also *Pearson v. Northeast Air Lines*, 309 F.2d 553, 558

specifically complained that the majority had "conspicuously refrained from stating in unmistakable terms that its new doctrine applies only to fraternal insurance companies" and expressed alarm at its consequences for commercial corporations.¹⁶⁰ The only case that explicitly tried to escape *Wolfe* is *Western Air Lines, Inc. v. Sobieski*,¹⁶¹ whose holding, except as it applies to pseudo-foreign corporations, is no longer viable under the commerce clause.¹⁶² In contrast, in *National City Lines v. LLC Corp.*,¹⁶³ a recent case involving proxy solicitation and voting in a commercial corporation, *Wolfe* reappeared to support the application of the law of Delaware, the state of incorporation.

The basic premise of *Wolfe*, the need for national uniformity for internal corporate affairs, remains widely accepted.¹⁶⁴ To paraphrase *Wolfe* and its predecessors, shareholders voluntarily associate to pursue common interests and their interdependence arises from their continuing relationship with one another. The corporate venture is run by common institutions through a representative form of government. Elementary considerations of predictability, practicality, and equality call for both corporate governance and the common rights and obligations of the shareholders to be subject to a single law.¹⁶⁵ Full faith and credit gives primacy to the statute chosen by the parties with the consent of the state of incorporation. *Wolfe* recognizes that the forum state's legitimate interests may, in an extraordinary situation, override the obligation to apply

n.12 (2d Cir. 1962) (*Wolfe* dealt with a "unique situation," the relationship between members of a fraternal benefit society, and should not be extended to commercial corporations).

160. *Wolfe*, 331 U.S. at 641-42 (Black, J., dissenting). The real concern of the dissenters was not corporate governance but insurance practices. They were afraid that, under the guise of the "internal affairs" exclusion, insurance companies would be able to evade the law of the states where they did business and sign up "members" who in reality were policyholders. *Id.* at 636-42.

161. 191 Cal. App. 2d 399, 12 Cal. Rptr. 710 (1961).

162. See *infra* notes 189-93 and accompanying text.

163. FED. SEC. L. REP. (CCH) ¶ 98,374 (W.D. Mo. 1981), *aff'd*, 687 F.2d 1122 (8th Cir. 1982).

164. On the continuing relevance of full faith and credit in fields where there is a need for national uniformity, see Boehm, *State Interests and Interstate Commerce: A Look at the Theoretical Underpinnings of Takeover Legislation*, 36 WASH. & LEE L. REV. 733, 754 (1979); Kirgis, *The Roles of Due Process and Full Faith and Credit in Choice of Law*, 62 CORNELL L. REV. 94, 120, 139-42 (1976); Oldham, *Regulating the Regulators: Limitations Upon a State's Ability to Regulate Corporations with Multi-state Contacts*, 57 DEN. L.J. 345, 356-68 (1980); Weintraub, *supra* note 147, at 455, 478-79. See generally I. CROSSKEY, *POLITICS AND THE CONSTITUTION IN THE HISTORY OF THE UNITED STATES* 541-57 (1953) (discussing the importance of a national system of law in the United States).

165. *Wolfe*, 331 U.S. at 592, 601, 605-06. See also *Sovereign Camp of the Woodmen of the World v. Bolin*, 305 U.S. 66, 68 (1938) (entry into membership of fraternal society is more than contract; it is entering into "complex and abiding" relation); *Modern Woodmen of America v. Mixer*, 267 U.S. 544, 551 (1924); *Supreme Council of the Royal Arcanum v. Green*, 237 U.S. 531, 542 (1915) ("intrinsic relationship between each and all of the members . . . and a resulting unity between them").

the law of another state—as was permitted in *Alaska Packers*.¹⁶⁶ But the Court in *Wolfe* nevertheless concluded that, in the corporate context, both the need for uniformity and the unity of the bundle of rights and obligations of corporate membership override the protective interests of the state of residence of particular members.¹⁶⁷

C. *The Conflicts Implications of Edgar v. MITE Corp. and of the Revitalized Commerce Clause.*

Whatever the status of *Wolfe* before 1982, there is little question that *Edgar v. MITE Corp.*¹⁶⁸ gave the single-law and lex incorporationis principles an indirect but significant boost under the commerce clause. The context of *MITE* was not the typical internal affairs situation. At issue was whether a takeover statute that subjected certain tender offers to state law controls was unconstitutional under the commerce clause, or was at least preempted as inconsistent with the Williams Act.¹⁶⁹

Takeover statutes proliferated in the 1960's and 1970's, and thirty-seven states had enacted such laws by the early 1980's. The application of these statutes is triggered by an offer to buy shares; their ostensible

166. 294 U.S. 532, 542 (1935); see also *Pacific Ins. Co. v. Comm'r*, 306 U.S. 493, 499 (1939).

167. *Wolfe*, 331 U.S. at 623-25. A careful reading of the dissent shows that their concern is less with corporate choice of law than with the general proposition that full faith and credit should mandate any choices of law in multistate transactions.

The full faith and credit derivation of the single-law principle, with preference for the law of incorporation, to govern central internal affairs matters was eloquently argued by Professors Reese and Kaufman in their influential article. See Reese & Kaufman, *supra* note 1. Other supporters of this thesis include Coleman, *Corporate Dividends and the Conflict of Laws*, 63 HARV. L. REV. 433, 439, 460-67 (1950); Harper, *The Supreme Court and the Conflict of Laws*, 47 COLUM. L. REV. 883, 898 (1947); Hill, *Governmental Interest and the Conflict of Laws*, 27 U. CHI. L. REV. 463, 498-99 (1960). More recently, the practical necessity of applying the law of incorporation has been stressed by Ratner and Schwartz. See Ratner & Schwartz, *The Impact of Shaffer v. Heitner on the Substantive Law of Corporations*, 45 BROOKLYN L. REV. 641, 665-74 (1979).

168. 457 U.S. 624 (1982). The decision's negative impact on state takeover statutes rather than its significance for internal corporate affairs has received the most attention. See Profusek & Gompf, *State Takeover Legislation After MITE: Standing Pat, Blue Sky or Corporation Law Concepts?*, 7 CORP. L. REV. 3 (1983); Sargent, *Do the Second-Generation State Takeover Statutes Violate the Commerce Clause?*, 8 CORP. L. REV. 3 (1985); Warren, *Developments in State Takeover Regulation: Mite and its Aftermath*, 40 BUS. L. 671 (1985); Note, *The Unsung Death of State Takeover Statutes: Edgar v. MITE Corp.*, 24 B.C.L. REV. 1017 (1983); Note, *State Takeover Statutes Under Attack—Casualties in the Battle for Corporate Control—Mite Corp. v. Dixon*, 30 DEPAUL L. REV. 989, 995-1023 (1981) [hereinafter cited as Note, *State Takeover Statutes Under Attack*]; Note, *The Supreme Court, 1981 Term*, 96 HARV. L. REV. 62, 62-71 (1982); Note, *Corporate Battles for Control—Edgar v. Mite and the Constitutionality of State Takeover Legislation—The Continuing Saga*, 26 HOW. L.J. 1425 (1983) [hereinafter cited as Note, *Corporate Battles for Control*]; Note, *Tender Offers—Edgar v. Mite and State Tender Offer Regulation*, 9 J. CORP. L. 95 (1983) [hereinafter cited as Note, *Tender Offers*].

169. Pub. L. No. 90-439, 82 Stat. 454 (1964) (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982)).

purpose is to mandate disclosures and to prevent fraud in securities transactions.¹⁷⁰ Thus, they bear some resemblance to blue-sky laws and have been usually enacted in that form. Unlike blue-sky laws, however, which cover only intrastate transactions, takeover statutes reach tender offers, *wherever made*, if the target corporation, *not the transaction*, has certain contacts with the state.¹⁷¹ Other than place of incorporation, which is the chief one, such contacts may be found if either the principal place of business or the corporate headquarters is within the state, particularly when this circumstance is coupled with substantial assets and/or substantial shareholding within the state.¹⁷²

Precisely because of the concern created by the extraterritoriality of takeover statutes, their proponents argue that the statutes control not securities transactions but the internal affairs of corporations. Consequently, such legislation constitutes an exercise of the authority of a state to regulate domestic or locally-centered corporations.¹⁷³ The fact remains, however, that acquisitions of stock under a tender offer do not in themselves alter the corporate structure, procedures, and relationships, nor do they necessarily lead to a structural change; the acquirer may be content with control at the shareholder level. Furthermore, the tender

170. For a recent summary review of particular provisions, see Note, *State Regulation of Tender Offers*, 7 J. CORP. L. 603, 606-11 (1982); Note, *Corporate Battles for Control*, *supra* note 168 at 1432-34.

171. Accordingly, the precedents upholding the constitutionality of the territorial blue-sky laws under the commerce clause have little relevance. See *Merrick v. N.W. Halsey & Co.*, 242 U.S. 568, 588-90 (1917); *Caldwell v. Sioux Falls Stock Yards*, 242 U.S. 559, 564-66 (1917); *Hall v. Geiger Jones Co.*, 242 U.S. 539, 557-59 (1917); see also Loss, *The Conflict of Laws and the Blue-Sky Laws*, 71 HARV. L. REV. 209, 241-53 (1957) (discussing the problems in applying blue-sky laws to multi-state security transactions).

Section 414 of the Uniform Securities Act approved in 1958 and adopted by many states exemplifies the strict territoriality of blue-sky law. For a discussion of the meaning and implications of this section see Long, *The Conflict of Laws Provisions of the Uniform Securities Act, or, When Does a Transaction "Take Place in this State?"*, 31 Okla. L. Rev. 781 (1978).

172. See E. ARANOW, H. EINHORN & G. BERLSTEIN, *supra* note 5, at 207-17, 232-323 (1977); Bartell, *State Corporate Takeover Regulation*, 15 SEC. REG. & L. REP. (BNA) No. 16, at 807, 807 n.1 (Apr. 22, 1983); Langevoort, *State Tender-Offer Legislation: Interests, Effects and Political Competency*, 62 CORNELL L. REV. 213, 219-20 (1977); Warren, *supra* note 168, at 676; Note, *State Regulation of Tender Offers*, *supra* note 170, at 605-06; Note, *The Constitutionality of State Takeover Statutes: A Response to Great Western*, 53 N.Y.U. L. REV. 872, 880-81 (1978).

173. The explanation for the internal affairs characterization is that tender offers typically (a) result in shifts in control that affect management, (b) change the position of the remaining shareholders, (c) lead to mergers or consolidations or other fundamental changes, and/or (d) resemble and are functionally equivalent to proxy solicitations. See Shipman, *Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act*, 21 CASE W. RES. L. REV. 722, 740-61 (1970). See also *AMCA Int'l Corp. v. Krause*, 482 F. Supp. 929, 931-39 (S.D. Ohio 1979) ("Tender offers are to be considered functionally as internal affairs transactions . . . in which a state possesses a compelling interest: investor protection."); Boehm, *supra* note 164, at 743, 756; Profusek & Gompf, *supra* note 168, at 27-31.

offeror need not be a shareholder and the accepting offeree ceases to be one.¹⁷⁴

It was in this context that the Supreme Court in 1982 decided *MITE*.¹⁷⁵ The Illinois statute attacked in that case applied to a tender offer, wherever made, for the stock of a target company if either (a) at least ten percent of such stock was owned by Illinois residents or (b) two out of the following three contacts were present in Illinois: incorporation, principal executive office of the corporation, or at least ten percent of the stated capital and paid-in surplus.¹⁷⁶ Was it constitutional for Illinois to apply this statute to a nationwide tender offer for the stock of an Illinois corporation, where the latter had its principal place of business in Pennsylvania and where forty-three percent of its stock was owned by Illinois residents? In an opinion by Justice White, a majority of five justices found that the statute unduly burdened interstate commerce.¹⁷⁷

The *MITE* majority rejected the argument that the Illinois statute regulated "internal affairs" rather than just "transactions" in the shares of the target company, and held that the attempt to exercise comprehensive control over out-of-state transactions among non-residents constituted a major burden on interstate commerce.¹⁷⁸ The Illinois interest in protecting local investors, while legitimate, could not outweigh such a burden. The state interest was minor, speculative, and implausible because the statute was applicable "even if not a single one of [the target's] shareholders were a resident of Illinois."¹⁷⁹

Justice White, joined by Chief Justice Burger and Justices Stevens and O'Connor, also found the Illinois statute invalid *per se* because it purported to regulate elements of interstate commerce *directly*.¹⁸⁰

The Commerce Clause also precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, *whether or not the commerce has effects within the state*. . . . The lim-

174. See *Great Western United Corp. v. Kidwell*, 577 F.2d 1256, 1280 n.53 (5th Cir. 1978), *rev'd for improper venue sub nom. Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979); see also Wilmer & Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality*, 45 *FORDHAM L. REV.* 1, 16-17 (1976); Note, *Commerce Clause Limitations Upon State Regulation of Tender Offers*, 47 *S. CAL. L. REV.* 1133, 1133-55 (1974).

175. The Supreme Court had raised hopes of an early authoritative pronouncement on these issues when it granted certiorari in *Great Western United Corp. v. Kidwell*, but it disposed of the case on venue grounds. *Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979).

176. *ILL. REV. STAT.*, ch. 121, § 137.52-10 (1979).

177. *MITE*, 457 U.S. at 626-46. Three justices dissented on the technical ground that the case was moot. *Id.* at 648-54 (Marshall, J., dissenting). Justice Blackmun did not address the commerce clause issue but agreed with the result on a federal preemption theory. *Id.* at 633 (Blackmun, J., concurring).

178. *Id.* at 643-46.

179. *Id.* at 642.

180. *Id.* at 643.

its on a State's power to enact substantive legislation are similar to the limits on the jurisdiction of state courts. In either case "any attempt 'directly' to assert extraterritorial jurisdiction over persons or property would offend sister States and exceed the inherent limits of the State's power."¹⁸¹

181. *Id.* at 642-43 (emphasis added) (quoting *Shaffer v. Heitner*, 433 U.S. 186, 197 (1977)). The reference to *Shaffer*, a due process jurisdiction case, is puzzling. The Court in *Shaffer* states quite explicitly that even though the judicial and legislative jurisdictional inquiries have certain similarities, they are not identical. That a state has the power to have its law applied does not necessarily mean that it can adjudicate the controversy. *Shaffer*, 433 U.S. at 215-16, 224-25. The language relied upon by Justice White in *MITE* came from that part of the *Shaffer* opinion that discussed *Pennoyer v. Neff*, 95 U.S. 714 (1878), the case which *Shaffer* overruled. Is Justice White purporting to eliminate the distinction between the two jurisdictional inquiries, at least where interstate commerce is involved? Further, it is generally recognized that for judicial jurisdiction a "minimum contacts" test applies, and direct, substantial, foreseeable "effects" within the territory suffice. Why should legislative jurisdiction not attach to such "effects"? Was Justice White perhaps limiting the similarity to the exclusion as a valid jurisdictional basis of *indirect* effects only on people—shareholders resident within the territory?

In any event, Justice White's stricter view has been favorably received by some lower courts in ways that portend a further extension of the negative reach of the commerce clause. For example, in *Telvest, Inc. v. Bradshaw*, 547 F. Supp. 791, 797 (E.D. Va. 1982), *aff'd*, 697 F.2d 576 (4th Cir. 1983), the court followed the four *MITE* justices and concluded that a comparable Virginia statute was a "direct" restraint and invalid *per se*. The court stressed that none of the other justices had rejected or otherwise addressed the "direct" restraint analysis. *See also* *Bendix Corp. v. Martin Marietta Corp.*, 547 F. Supp. 522, 524, 534-39 (D. Md. 1982) (similar treatment of the Michigan takeover statute).

More recently, the Supreme Court signaled that the "supposedly precise division between 'direct' and 'indirect' effects on interstate commerce" was being abandoned and that, in every case, we must now look to the "nature of the state regulation involved, the objective of the state, and the effect of regulation upon the national interest in the commerce." *Arkansas Electric Corp. v. Arkansas Pub. Comm'n*, 103 S. Ct. 1905, 1910 (1983). While this approach will probably eliminate the *per se* invalidity of any restraint, it is likely to increase the scrutiny for extraterritorial effects, thus strengthening the *Martin Marietta* interpretation of *Edgar v. MITE Corp.*

Professor Richard Buxbaum, in a profound and comprehensive study of the implications for state securities and corporate law of *Edgar v. MITE Corp.* and of other cases raising commerce clause and preemption issues, expects a "surge [in challenges] in the near future." Buxbaum, *Federalism and Corporate Law*, 82 MICH. L. REV. 1163, 1166 (1984). He is quite critical of a laissez-faire perception of the commerce clause which leads to the invalidation of state corporate-type legislation. He engages in elaborate efficiency analysis and concludes that, so long as state legislation does not discriminate against interstate capital resource flows, it should not be subjected to commerce clause scrutiny. *Id.* at 1168-80. In other words, he is unhappy about the extension of the clause beyond discrimination to pure overreaching through extraterritoriality.

Whether recourse should be had to the due process and full faith clauses, rather than to the commerce clause, to curb such overreaching is a fine doctrinal issue. Nevertheless, that state law extraterritoriality in the corporate field raises serious state-versus-state federalism questions cannot be denied. Buxbaum himself recognizes that state antitakeover law cannot be made applicable to a foreign corporation solely because one shareholder resides there; this would "impose significant externalities on other states," and an "indirect barrier to the interstate mobility of resources would be created." *Id.* at 1173-74. Yet, under his analysis such externalities and a regulation of the mobility of resources runs afoul of the commerce clause only if they are discriminatory. Buxbaum is also too sanguine about the ease with which dissatisfied shareholders can reincorporate in another state or use the capital markets to circumvent state overreaching.

The *MITE* majority was quite explicit in its concern over the burden and delay caused by the state-by-state regulation of nationwide tender offers.¹⁸² The same evil, however, may arise through local regulation of local transactions where, as a practical matter or because of requirements of uniform or equal treatment, some out-of-state transactions must also conform.¹⁸³ Even if the characterization of the Illinois statute as regulating solely internal corporate affairs were accepted, the statute would still not survive scrutiny under the commerce clause. In its alternative holding, the *MITE* majority noted that the only reason Illinois claimed authority to regulate was because ten percent of the outstanding shares were held by Illinois residents. The Act "applies to corporations that are not incorporated in Illinois and have their principal place of business in other states. Illinois has no interest in regulating the internal affairs of

Professor Tribe's general position on the reach of the negative Commerce Clause is closer to that advocated in the text. While Tribe appears to share Buxbaum's position that the commerce clause should not be read to constitutionalize "an economic theory of free trade," he also stresses that the "function of the clause is to insure national solidarity, not national efficiency." L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 25 (1978 & Supp. 1979).

182. *MITE*, 457 U.S. at 642.

183. Commerce clause cases both prior and subsequent to *MITE* have taken a broad view of what unduly burdens out-of-state transactions and have included in their calculus the extraterritorial effects of intra-state regulation. A major case on this point is *Southern Pac. Co. v. Arizona*, 325 U.S. 761, 775 (1945), cited with approval in *MITE*, 457 U.S. at 643. See also *Morgan v. Virginia*, 328 U.S. 373, 377-86 (1946) (Virginia statute requiring separation of white and black passengers on interstate and intrastate motor carriers is unlawful burden on interstate commerce because of its effect on nationwide travel); *Baldwin v. G.A.F. Selig, Inc.*, 294 U.S. 511, 521-24 (1935) (interstate commerce unduly burdened by state law forbidding in-state resale of milk purchased from out-of-state farmers at prices below the minimum prices required to be paid in-state farmers). More recently, in *United States Brewers Ass'n v. Healy*, 692 F.2d 275, 278-84 (2d Cir. 1982), *aff'd*, 104 S. Ct. 265 (1983) (three justices noting probable jurisdiction and Justice Powell taking no part), the Second Circuit held that a Connecticut law which required brewers to file an affirmation that their Connecticut prices were not higher than their prices in neighboring states placed an unconstitutional burden on interstate commerce because of its effect on out-of-state prices even though the law was intended only to lower prices in Connecticut: "[I]t has been held repeatedly that where the practical effect of a state's legislation is to control conduct in other states, the regulation violates the Commerce Clause." *Id.* at 279-80. This logic has been extended to the area of tender offers. Post-*Edgar* cases suggest that limiting the applicability of a takeover statute only to intrastate tenders will not necessarily save it. A court may find a burden on interstate commerce if the local regulation would frustrate a multistate tender offer by, for example, reducing the total number of shares offered and thus indirectly nullifying the out-of-state tenders. See *Martin Marietta Corp. v. Bendix Corp.*, 690 F.2d 558 (6th Cir. 1982); *Occidental Petroleum v. Cities Service Co.*, FED. SEC. L. REP. (CCH) ¶ 99,063 (W.D. Okla. 1982). This approach may even undermine the prevailing assumption that the traditional blue-sky regulation is totally immune to commerce clause challenges. See *supra* note 171. Cf. *North Star Int'l v. Arizona Corp. Comm'n*, 720 F.2d 578, 583 (9th Cir. 1983) ("Supreme Court has consistently upheld the authority of states to enact blue-sky laws against commerce clause challenges."); *Petrites v. J.C. Bradford & Co.*, 646 F.2d 1033, 1036-37 (5th Cir. 1981) (blue-sky laws have consistently withstood commerce clause challenges). For a strong criticism of *Martin Marietta* and support for blue-sky state power, see Profusek & Goinpf, *supra* note 168, at 24-27. See also, R. WINTER, *GOVERNMENT AND THE CORPORATION* 8-29 (1978); Buxbaum, *supra* note 181 at 1179; *Sargent*, *supra* note 168, at 9.

foreign corporations."¹⁸⁴

The potential impact of the statement that a state has "no interest" in regulating the internal affairs of "foreign corporations" despite local shareholdings is far reaching. Such a statement leaves *nothing* to be placed in the constitutional balance under the test of *Pike v. Bruce Church, Inc.*¹⁸⁵ to justify *any* state interference in the internal affairs of "foreign corporations." Because the application of internal affairs law to a multistate corporation will affect interstate commerce in almost every instance, little room remains for the effectuation of local corporate policy. This "no interest" language also bears on how the "significant contacts generating state interests" due process test of *Allstate* will be applied in this field. Thus, regulating internal affairs without "interest" not only may burden interstate commerce, but also it may well violate due process.

How seriously should we take this limiting aspect of *MITE* in our analysis of state authority over internal corporate affairs? That the quotation appeared in an incidental discussion of the Court's alternative holding might make one cautious were it not for the fact that it is consistent with (a) the logic of the main holding in cutting down local control of out-of-state transactions and persons; and (b) the philosophy of *Wolfe*, which recognizes the interstate value of choosing a single law uniformly to govern these matters.¹⁸⁶ This interpretation gains support from the approving reference in *MITE* to the "internal affairs doctrine . . . a conflict of laws principle which recognizes that only one state should have authority to regulate a corporation's internal affairs . . . because otherwise a corporation could be faced with conflicting demands."¹⁸⁷

184. *MITE*, 457 U.S. at 645. This language was taken from the opinion below, *MITE Corp. v. Dixon*, 633 F.2d 486, 501 n.29 (7th Cir. 1980).

185. 397 U.S. 137, 142 (1970) (state statute may regulate interstate commerce indirectly but the burden imposed on that commerce must not be excessive in relation to the local interests served by the statute).

186. [P]rior to [*MITE*] more modern conflicts of law and other corporate law concepts had begun to recognize the importance of the actual presence of a corporation in a state rather than its technical locus of incorporation if the subject corporation does not have a meaningful presence within it. Nonetheless, after [*MITE*] the more traditional internal affairs analysis, which recognizes only the law of a corporation's state of organization, will be accorded the most significant weight, at least for purposes of constitutional analysis.

Profusek & Gompf, *supra* note 168, at 19 (citation omitted); see also Wolff, *The Unconstitutionality of the Arkansas Tender Offer Statute*, 36 ARK. L. REV. 233, 252-53 (1982); Note, *Tender Offers*, *supra* note 168, at 104-06; Note, *State Takeover Statutes Under Attack*, *supra* note 168, at 1018-19.

187. *MITE*, 457 U.S. at 645 (citation omitted). Similar language favorable to the lex incorporationis can also be found in other recent Supreme Court cases such as *First Nat. City Bank v. Banco Para El Comercio*, 462 U.S. 611 (1983); *Shaffer v. Heitner*, 439 U.S. 942, 952 (1977). See also Horowitz, *The Commerce Clause as a Limitation on State Choice-of-Law Doctrine*, 84 HARV. L. REV. 806 (1971). -

At the same time, however, *MITE* should not be read as constitutionalizing the lex incorporationis. The apparent recognition that the state of the principal place of business of a corporation may have an "interest," and the approving references to the protective interests of a state in its resident shareholders, leave room for an alternative internal affairs regime¹⁸⁸ or perhaps even the exceptional ad hoc application of certain local rules when the local policy is strong and the incidental burdens on out-of-state persons and transactions are minor.

The reinforcement of *Wolfe* by *MITE* should at least be deemed to have destroyed the alternate holdings of the two well-known interventionist cases, *Western Air Lines, Inc. v. Sobieski*¹⁸⁹ and *State ex rel Weede v. Iowa Southern Utilities Co. of Delaware*,¹⁹⁰ in which local policy had triumphed over the lex incorporationis. In *Western Air Lines*, the California Court of Appeals did not limit its holding to the pseudo-foreignness of the corporation but proceeded to distinguish *Wolfe*. The court held that a state has the power to apply its law to all corporate "dealings" in securities with local residents, especially where the corporation also does substantial in-state business, whatever its state of incorporation, principal place of business, or headquarters.¹⁹¹

188. "The [*MITE*] decision would not appear necessarily to preclude the states from regulating tender offers for local companies closely identified with one state, by virtue of incorporation, principal place of business and/or situs of a substantial number of shareholders." Pitt, *Hostile Tender Offers Now Omnipresent Fact of Life*, Legal Times, July 19, 1982 at 16, col. 3; cf. *Hi-Shear Indus. v. Campbell*, FED. SEC. L. REP. (CCH) ¶ 97,804, at 90,033 (D.S.C. 1980) (interest of state of incorporation to regulate internal affairs is recognized; state where some business is conducted and manufacturing facilities maintained has no such interest at least where headquarters are not located in the state).

189. 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961). A Delaware corporation with its principal place of business, corporate headquarters, and substantial shareholdings in California had held a shareholders' meeting in California to amend its charter and eliminate cumulative voting. Claiming that the change constituted a "sale" of securities in California within the reach of California's blue-sky law, the Commissioner of Corporations ruled that it was "unfair" to California shareholders and threatened sanctions if the amendment were implemented. The corporation won an injunction in the superior court on the ground that the commissioner had exceeded his jurisdiction. The court held that because the amendment was not a "sale" and, in any event, took effect in Delaware, the place of filing, which was beyond California's regulatory authority, the interference would violate full faith and credit. *Id.* at 401-03, 12 Cal. Rptr. at 721-22. The court of appeals reversed, stressing the California locus of the crucial events: the original exchange, with commissioner approval, of the stock of Western Air Lines for the stock of a prior California corporation; the proxy solicitation from and holding of the meeting and vote in California; and the residence of many shareholders in the state. *Id.* at 406, 12 Cal. Rptr. at 726. California later amended its statute to prohibit the assertion of jurisdiction over a foreign corporation unless the stock is not listed on the NYSE and at least 25% is owned in California. See CAL. BUS. & PROF. § 25103 (West 1984).

190. 231 Iowa 784, 2 N.W.2d 372 (1942), *aff'd sub. nom.*, *State ex rel. Weede v. Bechtel*, 239 Iowa 1298, 31 N.W.2d 853 (1948), *cert. denied*, 337 U.S. 918 (1949).

191. *Western Air Lines*, 191 Cal. App. 2d at 410-12, 12 Cal. Rptr. at 726-27 (citing *Watson v. Employers Liab. Assurance Corp.*, 348 U.S. 66 (1954)).

It is clear that this extended rationale cannot withstand the *MITE* scrutiny. Regulating corporate "dealings" with local residents may be legitimate, but using such dealings as a lever to subject multistate securities transactions or the internal affairs of foreign corporations to local control would violate the commerce clause. The presence of *some* local shareholdings and *some* local corporate business is insufficient to support the interference with voting rights that occurred in *Western Air Lines*, and that, as a practical matter, extended to all shares whatever their location and whatever the situs of the other corporate contacts. Even if it were possible to engraft cumulative voting rights on only the shares held in California, the out-of-state holders would have been prejudiced. Interstate commerce would have been thereby burdened and questions of unconstitutional discrimination would have arisen.¹⁹² The criticism of *Western Air Lines* by Professors Reese and Kaufman¹⁹³ finally bore fruit in *MITE*, albeit under the commerce rather than the full faith and credit clause.

Some states have sought to apply their corporate law to the financial requirements for the issuance of shares by local public utilities organized as foreign corporations. This was the case in *Weede*, in which the utility's headquarters, principal place of business, and assets were all located in Iowa. The Iowa Supreme Court was not content to rely on the pseudo-foreignness of the corporation, however, and proceeded to assert that a state has the power, consistent with full faith and credit, to apply its internal affairs law by virtue of the local business of a foreign corporation. The court stressed that although "the organic power of a foreign corporation depends upon the law of the state from which its existence is derived, in the exercise of such power in another jurisdiction the corporation must conform to the local laws and public policy."¹⁹⁴

But does the partial issuance of shares in Iowa constitute the exercise of the corporation's "organic power" in Iowa? Even before *MITE* a line of post-*Weede* cases determined that similar controls over multistate foreign corporations violated the commerce clause. In *United Air Lines v. Commerce Commission*,¹⁹⁵ for example, the Supreme Court of Illinois faced the question whether Illinois constitutionally could subject the issuance of stock by United Air Lines, a Delaware corporation, to the fiscal requirements of Illinois law and to the scrutiny of the Illinois

192. See Horowitz, *supra* note 187, at 819; Reese & Kaufman, *supra* note 1, at 1144; Small, *Changes in Rights, Preferences, Privileges and Restrictions on Outstanding Securities Under the California Corporate Securities Law*, 14 HASTINGS L.J. 94, 119, 122 (1962).

193. See Reese & Kaufman, *supra* note 1, at 1129.

194. *Weede*, 231 Iowa at 799, 2 N.W.2d at 387 (quoting 23 AM. JUR. *Foreign Corporations* § 91 (1939)).

195. 32 Ill. 2d 516, 207 N.E.2d 433 (1965).

Commerce Commission. United had executive offices in Illinois, but only a small fraction of its business involved intrastate routes or passengers. While the court recognized that a public utility incorporated out-of-state is subject to the regulatory authority of a state insofar as it "operate[s] within the state, including the issuance of stock," it ruled that the issuance of securities is a "single, invisible act . . . [that] cannot be fractionalized and given portions allocated to specific states."¹⁹⁶ Subjecting the issue to a "public interest" review in the sixteen states in which United Air Lines operated, each of which had only a limited local interest, would be "unjustifiably expensive, time consuming and burdensome" and would violate the commerce clause.¹⁹⁷ In light of the interstate character of the business and the intended interstate use of the jet aircraft to be acquired with the proceeds of the issue, Illinois could not impose its own rules even on the intrastate portion of the issue.¹⁹⁸

It may be that *United Air Lines* and other similar cases¹⁹⁹ remain obscure and undiscovered by conflicts and constitutional experts. Nevertheless, not only are these cases harbingers of *MITE*'s "no interest" holding, but also they strongly support the commerce clause presumption against interference in the internal affairs of foreign corporations. They further suggest that the controls involved in *Weede* overstep the constitutional boundaries.²⁰⁰ State controls over the issuance and transfer of the stock of public utility and public resource corporations have continued to be subjected to commerce clause scrutiny after *MITE*. For example, in *Baltimore Gas & Electric v. Heintz*,²⁰¹ a Maryland statute prohibited the acquisition anywhere of more than ten percent of the stock of public utilities by any stock corporation. It was clear that the statute, which applied only to corporations organized in Maryland, did not have a

196. *Id.* at 525, 207 N.E.2d at 438.

197. *Id.* at 524, 207 N.E.2d at 438.

198. *Id.*

199. For a similar pre-*MITE* application of the commerce clause in this field, see *United Air Lines, Inc. v. Nebraska State Ry. Comm'n*, 172 Neb. 784, 112 N.W.2d 414 (1961); *State ex rel. Utilities Comm'n v. Southern Bell Tel. & Tel.*, 288 N.C. 201, 217 S.E.2d 543 (1975); *Panhandle E. Pipe Line Co. v. Public Util. Comm'n*, 56 Ohio St. 2d 334, 383 N.E.2d 1163 (1978). That the foreign incorporation of the companies involved was the crucial factor is corroborated by other cases where similar restrictions by the state of incorporation have been upheld. See, e.g., *Michigan Gas Storage v. Michigan Pub. Serv. Comm'n*, 405 Mich. 376, 397-99, 275 N.W.2d 457, 464-65 (1979); *People v. County Transp. Co.*, 303 N.Y. 391, 401-02, 103 N.E.2d 421, 427-28, *appeal dismissed*, 343 U.S. 961 (1952).

200. The result in *Weede* may perhaps be sustainable under either a "limited intervention" or an "external affairs" analysis as effectuating a substantial local interest while imposing minimal burdens on interstate commerce. The emphasis here will be on the local concern for the fiscal soundness of local utilities and on the ease of compliance with certain stock issuance revenue requirements involving operational rather than internal affairs controls.

201. 582 F. Supp. 675 (D. Md. 1984). See MD. ANN. CODE art. 78, § 24(c) (1980).

discriminatory intent against or effect upon interstate commerce. In holding, however, that it placed an excessive burden on such commerce as measured against the purported local interest, the Federal district court stressed that the state could have achieved the desired end in a less restrictive way, for example, by subjecting the stock acquisitions to scrutiny rather than prohibition.²⁰² But even this latter concept may run afoul of the commerce clause. This is suggested by the reported order of United States District Judge Cook in the highly controversial Icahn/Phillips Petroleum battle²⁰³ which blocked, apparently on commerce clause grounds, the enforcement of a new Oklahoma statute which subjects to the approval of the state corporation commission all acquisitions of more than ten percent of the stock of a corporation, wherever formed, owning more than \$75 million in energy resources in Oklahoma.²⁰⁴

The revitalization in *MITE* of the impact of the commerce clause to control legislative overreachings by the states in the absence of federal preemption²⁰⁵ is welcome. Discrimination against interstate commerce in the pursuit of parochial interests may be the most obnoxious type of state interference, but it is not the only one. Extending a state's sense of justice, however non-discriminatory and well-intentioned, to multistate or multinational transactions not only offends the equal authority of the other states involved but, by opening up interstate and international commerce to conflicting demands, creates a disconcerting burden on citizens. When Congress has not enacted a uniform regime of regulation, such as a federal corporation law,²⁰⁶ protection against excessive local interference may be needed not only as a shield against local bias,²⁰⁷ but also as a

202. *Id.* at 679-82 (citing *Martin Marietta v. Bendix*, 690 F.2d 558 (6th Cir. 1982), the case which carried the *MITE* analysis to its ultimate conclusion). See also *Western Union Tel. Co. v. Public Service Comm'n*, 127 Mich. App. 88, 93-94, 338 N.W.2d 731, 735-36 (1983) (citing all the earlier public utility cases to the same effect).

203. See *Icahn Wins Round Against Phillips, Clearing His Bid*, Wall St. J., Feb. 15, 1985, at 13, col. 3-4.

204. Senate Bill No. 143 §§ 3(2),(3),(4)b,5(4),(6), 1985 Okla. Sess. Laws — — .

205. See Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 425 (1982); Tushnet, *Rethinking the Dormant Commerce Clause*, 1979 WIS. L. REV. 125, 165. For a critical view of *MITE*, see Buxbaum, *supra* note 181.

206. See *Morgan v. Virginia*, 328 U.S. 373, 377 (1946) (states may not regulate areas where national uniformity is required); *Simpson v. Shepard*, 230 U.S. 352, 396-97 (1913) (state regulation violates the commerce clause if it either directly burdens commerce or conflicts with federal law); see also Simson, *State Autonomy in Choice of Law: A Suggested Approach*, 52 S. CAL. L. REV. 61, 73 (1979); von Mehren & Trautman, *supra* note 150, at 49-55; Weintraub, *Who's Afraid of Constitutional Limitations on Choice of Law?*, 10 HOFSTRA L. REV. 17, 25 (1981); cf. *Carroll v. Lanza*, 349 U.S. 408, 414 (1955) (Frankfurter, J., dissenting) (there is less need for national uniformity where the context is "simple contract rather than shareholder-corporation law").

207. See, e.g., *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 675-76 (1981) (court shows less deference to local regulations when there is a bias against out-of-state persons and businesses); *South Carolina State Highway Dept. v. Barnwell Bros.*, 303 U.S. 177, 185 n.2 (1938); *United*

means of securing an equitable, stable, and predictable regime for complex multistate and multinational relationships.²⁰⁸ The ascendancy of federalist values to check state legislative chauvinism is an overdue antidote to the almost total withdrawal exemplified by *Allstate*. By charting outer limits to the reach of state legislation, *MITE* is bound to place some overdue controls on "the centrifugal, isolating or hostile forces of localism"²⁰⁹ in choice of law.

This article does not attempt to trace the implications of *MITE* in all fields of choice of law in which interstate commerce may be implicated. At a minimum, it should seriously limit the freewheeling application of the law of any state of any contact in situations in which a transaction or relationship that requires unitary treatment is connected with more than one state. Furthermore, "minimum" interests do not suffice; the interests advanced by the application of a state's law to any issue must be strong enough to outweigh the consequent burden on interstate commerce. In addition, a literal application of the "direct restraint" analysis espoused by the four justices would leave the new conflicts in shambles. It is precisely through the substitution of personal for territorial contacts and of effects for conduct which would be limited, if not precluded, by the "direct restraint" analysis that the new conflicts has been able to justify the application of forum law in favor of local parties, especially plaintiffs, in disregard of the situs of the events and transactions.

We have come to the end of our constitutional inquiry, but not of our quest for conflicts justice in this field. Constitutionality is a prerequisite but not a sufficient determinant of such justice. That a state has the power to apply its own law does not necessarily mean that it should do so. As Justice Stevens noted in *Allstate*, Minnesota's approach was plainly "unsound as a matter of normal conflicts law" but still met the minimum constitutional requirements.²¹⁰ In choosing the law applicable to corporate internal affairs, the gap between what is permissible and what is desirable is quite narrow. The constitutional calculus already reflects recognition of the authority of the state of incorporation and of the value of selecting a single, predictable regime to govern the rights and obligations arising from the "indivisible" internal corporate relationship.

States Brewers Ass'n v. Healy, 692 F.2d 275, 279 (2d Cir. 1982), *aff'd*, 104 S. Ct. 265 (1983); see also J. ELY, *DEMOCRACY AND DISTRUST* 83-84, 90-91 (1980) (commerce clause protects out-of-state businesses and persons).

208. See Profusek & Gompf, *supra* note 168, at 29.

209. Brown, *The Open Economy: Justice Frankfurter and the Position of the Judiciary*, 67 *YALE L.J.* 219, 220 (1957); see also Hay, *Full Faith and Credit and Federalism in Choice of Law*, 34 *MERCER L. REV.* 709, 718-22 (1983); Silberman, *supra* note 150, at 130-31.

210. 449 U.S. at 331-32 (Stevens, J., concurring).

Consequently, we must now attempt to identify the exceptional circumstances in which the *lex incorporationis* not only could be, but also should be, overridden by local corporate policy.

VI. ALTERNATIVES TO OR DEVIATIONS FROM THE LEX INCORPORATIONIS: CONFLICTS ANALYSIS WITHIN THE CONSTITUTIONAL FRAMEWORK

The *lex incorporationis* has always enjoyed a strong position in American judicial and legislative practice, and *MITE* strengthened its constitutional supports. But no serious effort has been made to reassess this rule under the new conflicts methodologies. What is the explanation for this? Are the constitutional strictures too tight or the merits of the rule so obvious and weighty that a reconsideration would be superfluous? Do commentators find the subject too treacherous and unrewarding or are the courts and the legislatures too overburdened or tradition-bound to pursue this demanding and complex task? There is probably some truth in all of these possibilities.

A. *The New Conflicts, the Lex Incorporationis, and the "Real Seat" Rule.*

The conflicts revolution which gathered momentum in the 1960's and 1970's has made substantial inroads in the conflicts law of a majority of the states.²¹¹ While a detailed review of the differences and variations among the new conflicts approaches is beyond the scope of this article, it is useful to identify those common themes that are potentially relevant to choice of law for internal corporate affairs and to assess their impact on the *lex incorporationis*.

The more radical new approaches deemphasize three of the principal goals of traditional conflicts in favor of other considerations. First, the goals of forum-neutral justice and uniformity in the selection of the applicable law are attacked as unrealistic or even improper. Instead, it is postulated that forum policies and interests have priority and forum law normally should apply to all disputes before the court unless a persuasive case can be made for another law. The quest for the proper or most appropriate law must thus be abandoned.²¹²

Second, the goal of allocative justice—the distribution of law-making authority in the private law sphere among equal sovereigns on the basis of content-neutral criteria—must yield to the vindication of state

211. See *supra* note 50.

212. See E. SCOLES & P. HAY, *supra* note 51, at 17-20; Juenger, *Conflict of Laws: A Critique of Interests Analysis*, 32 AM. J. COMP. L. 1, 9-12 (1984).

interests in particular contexts and to the "substantive" justice of specific results.²¹³

Third, the goal of certain justice and the pursuit of predictability and ease of application through a system of conflicts rules is condemned as rigid, mechanical, and formalistic jurisprudence. In its place, certain general and open-ended standards such as "significant relationship" are used, and flexible methodologies are employed (a) to "discover" legislative intent bearing on the spatial and personal applicability of the policies and interests embodied in a state's substantive rules, and (b) to adjust the conflicting policies and interests of the various states of contact under vague formulae of compatibility and impairment.²¹⁴

Although neither the premises nor the pretensions of the conflicts revolution limit it to any particular area, its principal impact so far has been in the field of torts, in which it managed to destroy or at least qualify the *lex loci delicti*²¹⁵ in a majority of the states.²¹⁶ In other areas the penetration of the new conflicts has been minimal.²¹⁷ This is particularly true when the unity and uniformity of the applicable legal regime is important. For example, succession of property continues generally to be subjected to the law of the decedent's domicile at death for movables²¹⁸ and of the situs for immovables.²¹⁹ Domicile and situs also remain basically undisturbed, respectively, in status²²⁰ and property.²²¹

There is little doubt that in the context of the liberal rules of long-arm and doing-business jurisdiction, and of the mandates of full faith and credit on recognition and enforcement of judgments, the new conflicts have rewarded forum shopping and encouraged parochialism, particu-

213. See Hay, *Reflections on Conflict-of-Laws Methodology*, 32 HASTINGS L.J. 1644, 1659-62 (1981); Korn, *The Choice of Law Revolution: A Critique*, 83 COLUM. L. REV. 772, 807-11 (1983); Juenger, *supra* note 212, at 45-49.

214. R. CRAMPTON, D. CURRIE & H. KAY, *CONFLICT OF LAWS* 216-19, 291-95 (3d ed. 1981); 1 E. SCOLES & P. HAY, *supra* note 51, at 565-68; Juenger, *supra* note 212, at 14-28.

215. The term "*lex loci delicti*" refers to the law of the place where the wrong occurred.

216. See Reese, *American Trends in Private International Law: Academic and Judicial Manipulation of Choice of Law Rules in Tort Cases*, 33 VAND. L. REV. 717, 736-39 (1980).

217. See *id.* at 737 ("To date, other areas of the law have been relatively unscathed by most of the new approaches.").

218. See RESTATEMENT (SECOND), *supra* note 46, §§ 260-265; Reese, *supra* note 216, at 738; 1 E. SCOLES & P. HAY, *supra* note 51, at 766-95.

219. See RESTATEMENT (SECOND), *supra* note 46, §§ 236-242; 1 E. SCOLES & P. HAY, *supra* note 51, at 766-95.

220. See RESTATEMENT (SECOND), *supra* note 46, §§ 70-71, 285, 287; 1 E. SCOLES & P. HAY, *supra*, note 51, at 415-47, 535-51.

221. See RESTATEMENT (SECOND), *supra* note 46, §§ 223-232, 244-249, 251-256.

larly when the local law favored local parties.²²² In terms of substantive results, perhaps the most significant impact of the new conflicts has been to enable courts in tort suits to sidestep unpopular legislation such as guest statutes and limitations on the amount of recovery and immunities to suit. Indeed, most of the "landmark" new conflicts cases revolve around these issues.²²³

Whether, as a general matter, the sacrifices in practicality, neutrality, and comity brought about by the new conflicts are worth the candle; whether the new methodologies can be made to work in difficult areas and not only those, such as in personal injury torts, in which an overall compensatory goal makes easy the displacement of "anachronistic" defendant-protective devices; whether the yield in conflicts justice has increased in this flexible atmosphere; whether a better balance will eventually be struck between forum preference and free choice with the risks of "mishmash"²²⁴ conflicts, and the values of neutrality and predictability with the problems of conceptualist automaticity, are questions which this article cannot address. Mounting criticism of the premises and questioning of the promises of the new conflicts show that the jury is still out.²²⁵ Yet even under the new conflicts, there has been little challenge to the *lex incorporationis* as a presumptive rule. Whatever critical discussion there is relates to the justification of alternatives to or deviations from the rule rather than its abolition.²²⁶ This is quite remarkable

222. See Brilmayer, *Interests Analysis and the Myth of Legislative Intent*, 78 MICH. L. REV. 392, 410-11 (1980); Ely, *Choice of Law and the State's Interest in Protecting Its Own*, 23 WM. & MARY L. REV. 173 (1981).

223. See, e.g., *Rosenthal v. Warren*, 475 F.2d 438 (2d Cir.), cert. denied, 414 U.S. 856 (1973) (ceiling on damages); *Johnson v. Johnson*, 107 N.H. 30, 216 A.2d 781 (1966) (interspousal immunity); *Babcock v. Jackson*, 12 N.Y.2d 473, 191 N.E.2d 279, 240 N.Y.S.2d 743 (1963) (guest statute).

224. See Reppy, *Eclecticism in Choice of Law: Hybrid Method or Mishmash*, 34 MERCER L. REV. 645, 702-08 (1983).

225. Professors Hill and Rosenberg were the earliest critics of interests analysis and similar approaches. See, e.g., Hill, *Governmental Interests and the Conflict of Laws—A Reply to Professor Currie*, 27 U. CHI. L. REV. 463, 502-04 (1960); Rosenberg, *Two Views on Kell v. Henderson: An Opinion for the New York Court of Appeals*, 67 COLUM. L. REV. 459, 463-69 (1967). See also Juenger, *Choice of Law in Interstate Torts*, 118 U. PA. L. REV. 202 (1969); Twerski, Neuneier v. Kuehner: *Where are the Emperor's Clothes?*, 1 HOFSTRA L. REV. 104 (1973).

The more recent literature of the "unbelievers" includes: Bodenheimer, *The Need for a Re-orientation in American Conflicts Law*, 29 HASTINGS L.J. 731, 744-50 (1978); Brilmayer, *supra* note 222, at 429-31; Davies, *A Legislator's Look at Hague and Choice-of-Law Rules*, 10 HOFSTRA L. REV. 171, 193 (1981); Juenger, *supra* note 212, at 48-50; Kanowitz, *Comparative Impairment and Better Law: Grand Illusions in the Conflicts of Laws*, 30 HASTINGS L.J. 255, 293 (1978); Kegel, *Paternal Home and Dream Home: Traditional Conflict of Laws and the American Reformers*, 27 AM. J. COMP. L. 615, 619-24 (1979); Korn, *The Choice-of-Law Revolution: A Critique*, 83 COLUM. L. REV. 772, 965-66 (1983); Nagan, *Conflicts Theory in Conflict: A Systematic Appraisal of Traditional and Contemporary Theories*, 3 N.Y. J. INT'L & COMP. L. 343, 464 (1982); Rosenberg, *The Comeback of Choice-of-Law Rules*, 81 COLUM. L. REV. 946, 958 (1981).

226. See Latty, *supra* note 52 *passim*; Kaplan, *supra* note 1 *passim*.

when under the pro-forum, pro-resident-plaintiff biases of the new conflicts it would have been easy to attack the *lex incorporationis* as rigid and formalistic and to make a strong case for the vindication of the local corporate policy of the various other states of contact. This reticence may be due in part to a desire to avoid unfamiliar substantive issues. Perhaps, also, there is appreciation of the value of national uniformity in this field.²²⁷

Choice of law for internal corporate affairs is the subject *least* susceptible to the free-wheeling and forum-biased treatment typical of the more radical new conflicts methodologies. In the typical tort or contract dispute, the disfunctions of the new conflicts are least apparent. The case involves a single transaction or event and a dispute between two persons who have no continuing relationship with each other; the issues are few, self-contained, and can be dealt with conclusively in the proceedings; all the parties are before the court; the decision has no effect on non-parties; and the risk of inconsistent judgments is negligible. By contrast, internal corporate rules establish an entire system of private governance on a continuing basis involving persons—directors, officers, shareholders of various classes—performing different tasks and having potentially antagonistic interests. It would be intolerable to allow its component parts to be regulated under differing principles for different persons at different times. Rather, such a regime must be uniform and stable to promote efficient and equitable operation. The corporate participants need to know the rules of the game in advance and must be able to plan their transactions under fixed standards and procedures that determine their rights and liabilities. Beyond the requirements of unitary and constant governance, the corporate participants, especially the shareholders, justifiably expect and demand that they be treated equally with other persons similarly situated and not be subject to differential treatment depending on such variables as the place where a suit is brought, where some parties reside, or where the corporation has assets or does business.²²⁸

Another important difference between internal corporate affairs and the situations where the new conflicts have displaced the old rules lies in the matter of concession and autonomy. That is, the organizers of the corporation, with the consent of the state, have made an affirmative and

227. See *supra* note 164.

228. See R. LEFLAR, *AMERICAN CONFLICTS LAW* § 253 (3d ed. 1977) (it would be "intolerable" not to give all shareholders the same rights and duties); Sargent, *supra* note 53, at 19-20 (considerations of efficiency, practicality, predictability support single law); *RESTATEMENT (SECOND)*, *supra* note 46, § 302 comments e & f, § 309 comment c.

voluntary choice of the state of incorporation.²²⁹ Historically, the *lex incorporationis* was derived from the very concept of the corporation as an artificial entity created and perpetuated by the state of incorporation.²³⁰ This conceptual explanation is now wedded to a consensual rationale: the choice of the state of incorporation comes about by agreement among the organizers and its law is selected, explicitly or implicitly, to govern this private internal corporate relationship. It is therefore fair and reasonable that they be bound by it.²³¹

The autonomy of the parties and the protection of party expectations are given substantial weight in both the traditional and the new conflicts.²³² The parties' choice of law is honored unless it is arbitrary.²³³ Under the new conflicts, such choice will probably be scrutinized more carefully when the law of the forum is to be displaced.²³⁴ The lack of any connection between the law chosen and the parties or the transactions may be more blatant in the field of internal corporate affairs where charters are always available. There is therefore some room for the state of the predominant contacts to challenge the *lex incorporationis* in exceptional situations.

The preclusive effect of judgments under the doctrines of *res judicata* and collateral estoppel reinforces the need to choose one constant law to govern all internal affairs disputes. A judgment in a derivative action merges all the related claims and precludes another suit not only by the parties but also by any other shareholder in any forum.²³⁵ Thus,

229. See R. LEFLAR, *supra* note 228, at § 253.

230. See *id.* § 251.

231. See *supra* note 228. Furthermore, at least in free-enterprise countries, giving maximum freedom to the organizers is consistent with the private nature of the corporate relationships and with the enabling philosophy of corporate law. But see Sargent, *supra* note 53, at 18-19 (creature-of-the-state, intent of parties formalistic, not connected to any state interests).

232. See RESTATEMENT (SECOND), *supra* note 46, § 187; Covey & Morris, *The Enforceability of Agreements Providing for Forum and Choice-of-Law Selection*, 61 DEN. L.J. 837, 837-60 (1984); Kozyris, *Justified Party Expectations in Choice of Law and Jurisdiction: Constitutional Significance or Bootstrapping?*, 19 SAN DIEGO L. REV. 313, 314-16 (1982); see also 1 E. SCOLES & P. HAY, *supra* note 51, at 632-36 (and authorities cited therein).

233. See 1 E. SCOLES & P. HAY, *supra* note 51, at 637-49 (and authorities cited therein).

234. See Note, *Effectiveness of Choice-of-Law Clauses in Contract Conflicts of Law: Party Autonomy or Objective Determination?*, 82 COLUM. L. REV. 1659, 1691 (1982) (the policy and interest orientation of the new conflicts requires that party choice of law, at least in ordinary contracts, should be treated as just another contact).

235. A recent famous dispute illustrates this point. Four stockholders, Auerbach, Linnner, Cramer, and Parkoff, each brought separate derivative actions on behalf of General Telephone & Electronics Corp. (GTE) against its directors, claiming that the corporation had made questionable payments to foreign officials. They all alleged misuse and waste of corporate assets and breach of fiduciary duties. GTE's board of directors consequently created a special litigation committee, consisting of three directors who had joined the board subsequent to the alleged wrongdoing, to determine what position the corporation should take. After more than six months of investigation, the

without the *lex incorporationis*, an unhealthy incentive will be created for some shareholders to forum- and law-shop in ways prejudicial to the interests and positions of other shareholders. Furthermore, adjudication may prejudice non-party shareholders to the extent that the corporation, usually amenable to suit in many fora, is bound by the related judgments. New actions by these shareholders may also result in inconsistent judgments and serious difficulties of enforcement.

The final advantage of the *lex incorporationis*, like democracy, is the lack of a better alternative. It is often said that most continental countries use the "real seat" rule,²³⁶ but in reality this so-called rule represents a limited departure from, not an alternative to, the *lex incorporationis*. In Europe, as in the United States, a corporation is formed under the chosen law of a particular jurisdiction. The law normally requires that the registered seat of the corporation, as specified in

committee found no breach of duty by the defendant directors and no merit to the stockholders' claims. The committee determined that it would not be in the best interest of the corporation for the derivative actions to proceed, and upon the committee's report, the corporation sought dismissal of the actions. All four cases were dismissed by different courts. *Cramer v. G.T.E.*, 582 F.2d 259 (2d Cir.), cert. denied, 439 U.S. 1129 (1980); *Limmer v. G.T.E.*, 76 Civ. 1494 (S.D.N.Y. March 11, 1977); *Parkoff v. G.T.E.*, 53 N.Y.2d 412, 425 N.E.2d 820, 442 N.Y.S.2d 432 (1981); *Auerbach v. Bennett*, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

In *Parkoff* the New York Court of Appeals explored the *res judicata* effect of the earlier adjudications and held that the federal court's decision in *Cramer* barred *Parkoff's* claims under the doctrine of *res judicata* because: (1) in *Cramer* the court had already considered all of the questionable activities of GTE that *Parkoff* mentioned in his complaint; (2) there was no showing that *Parkoff* unsuccessfully sought to intervene in *Cramer*; (3) there was no showing of collusion or fraud on shareholders who were not parties to *Cramer's* action; and (4) *Cramer* was dismissed on the merits. 53 N.Y.2d at 414, 425 N.E.2d at 84, 442 N.Y.S.2d at 434. The court, however, did hold that certain of *Parkoff's* claims were not barred by *Auerbach* not only because they were different from *Auerbach's* but also because *Parkoff*, unlike *Auerbach*, had not been able to complete pretrial discovery and his attempt to intervene in *Auerbach* had been denied. 53 N.Y.2d at 417-18, 425 N.E.2d at 825, 442 N.Y.S.2d at 436-37. For further discussion of these complexities, see 51 CORP. REP. BULL. (PH), No. 16, at 1-2 (July 4, 1981). See also *Tanzer v. Turbodyne*, 68 A.D.2d 614, 417 N.Y.S.2d 706 (N.Y. Sup. Ct. 1979); Note, *Res Judicata in Derivative Actions*, 45 ALA. L. REV. 145 (1982).

236. See, e.g., A. CONARD, *CORPORATIONS IN PERSPECTIVE* 15 (1976); 2 A. EHRENZWEIG, *PRIVATE INTERNATIONAL LAW* 121-24 (1973); E. STEIN, *HARMONIZATION OF EUROPEAN COMPANY LAWS* 29, 53 (1971).

For a fuller description and discussion of the "seat" concept, see W. BACHE, *DER INTERNATIONALE UNTERNEHMENSVERTRAG NACH DEUTSCHEM KOLLISIONSRECHT* (1966) H. BATIFFOL & P. LAGARDE, *LE DROIT INTERNATIONAL PRIVE* §§ 229-240 (7th ed. 1981); D. EVRIGENIS, *PRIVATE INTERNATIONAL LAW* 206-41 (1973); H. G. KOPPENSTEINER, *INTERNATIONALE UNTERNEHMEN IN DEUTSCHEN GESELLSCHAFTSRECHT* (1971); E. KRISPIS, *JURIDICAL PERSONS, ESPECIALLY COMMERCIAL CORPORATIONS, IN PRIVATE INTERNATIONAL LAW* (1950); LEBEN, *UNE TENATIVE DE PERCEPTION GLOBALE: LE RECOURS À LA NATIONALITÉ DES SOCIÉTÉS IN L' ENTERPRISE MULTINATIONALE FACE AU DROIT* 216, 221-28 (1977). G. MARIDAKIS, *PRIVATE INTERNATIONAL LAW* 434-53 (1967); D. PAPASTERIOU, *THE SEAT OF JURIDICAL PERSONS IN PRIVATE LAW* (1979); 2 E. RABEL, *THE CONFLICT OF LAWS: A COMPARATIVE STUDY* 33-36 (1960); Coester-Waltjen, *German Conflict Rules and the Multinational Enterprise*, 6 GA. J. INT'L & COMP. L. 197 (1976).

the articles, be located in the state of incorporation. If, however, the "real" seat does not coincide with the registered one or is subsequently moved to another state, there is "fraude a la loi." This is a technical violation that not only undermines "good standing" at the state of incorporation but also opens the way for the state of the "real seat" to "pierce the veil" of foreign incorporation and refuse to recognize the corporate existence or even subject the internal corporate affairs to its own law.²³⁷ In other words, the practical operation of the "real seat" rule is to require not only corporate existence but an *additional and real connection* to the state of incorporation.

Perhaps when most private commerce stopped at the national frontiers and managers and shareholders happened or were even required to be citizens of the incorporating nation, it made considerable sense to attribute a "nationality" to the corporation based on a genuine connection and recognize, under continental conflicts, that the national state controlled its existence and organization. The formal argument that the discrepancy between a registered and a "real seat" constitutes "fraude a la loi" is buttressed by the power of a state to impose its own sense of justice on the internal affairs of corporations centered there. Thus, the "real seat" served as a surrogate for the state of the dominant contacts and interests.²³⁸ This was not unreasonable when the practical and formal necessities of operations made the assumed coincidence quite probable in fact. With the expansion of corporate activities across national frontiers and the separation between management (center of administration) and assets and operations (center of exploitation), the question of which of these is the better connecting factor had to be addressed. Continental practice continued to prefer "administration" based on the perception that the nation where the corporate "brain" or "nerve center" is located, where the key corporate decisions are made, and where "control" is exercised, has the greater concern about and power over internal corporate affairs.²³⁹ Yet there still remains a lack of consensus as to where this "administration" is actually located. The majority view equates "administration" with the directors while alternative theories advocate the place where shareholders meet and act.²⁴⁰ The uncertainty is compounded by the fact that different nations at various times, while using the same standard, arrive at differing conclusions as to where a particular seat is lo-

237. See 2 E. RABEL, *supra* note 236, at 38-40; Conard, *Organizing for Business*, in 2 E. STEIN & T. NICHOLSON, *AMERICAN ENTERPRISE IN THE EUROPEAN COMMON MARKET* 1, 61-62 (1960).

238. See 2 E. RABEL, *supra* note 236, at 33-68.

239. See *id.* at 40-41; see also Palmer, *The Austrian Codification of Conflict Law*, AM. J. COMP. L. 197, 224 (1980) (discussing Article 10 of the new Austrian statute on Private International Law, enacted in 1978, which refers to the place where the corporation has its chief executive office).

240. See 2 E. RABEL, *supra* note 236, at 41-42, 47-50.

cated. In addition, the constancy in the applicable law is continuously in jeopardy through changes in the patterns and locations of corporate administration. The more diverse and multinational are the corporate operations, the less plausible is the role of the "real seat" as the situs of the most significant relationship. The states of nationality and residence of the shareholders or of the principal business operations may assert an equal or superior right of regulation, especially because these contacts are not only more meaningful under an effects test, but are also more difficult to manipulate than the place where the directors' or shareholders' meetings are held.

The elusiveness of the corporate center or domicile is tellingly illustrated by the experience of the United States with the concept of corporate "citizenship" in federal diversity jurisdiction. Under 28 U.S.C. § 1332(c) (1982), a corporation is deemed a citizen of the state "by which it has been incorporated" as well as of the state where "it has its principal place of business." Incredible difficulties have been encountered by the courts in localizing this single principal place of business and at least five difficult and contradictory tests have been used—nerve-center, center-of-operations, place-of-acting or physical assets, maximum-public-visibility, and totality-of-corporate-activity tests.²⁴¹ The greater mobility of resources and corporate operations makes the "real seat" or "headquarters" rule even less suitable in the United States than in Europe.

Even in its European cradle, the "seat" rule is losing ground.²⁴² The Netherlands stubbornly continues to ignore it,²⁴³ and Switzerland is confirming its opposition to it.²⁴⁴ Many draft international conventions, where the continental views predominate, such as the Hagne 1956 Convention²⁴⁵ and the 1968 European Economic Community Convention on

241. See P. BLUMBERG, *THE LAW OF CORPORATE GROUPS* 220-36 (1983). For an exhaustive discussion of corporate contacts, see the classic work of A. FARNSWORTH, *THE RESIDENCE AND DOMICILE OF CORPORATIONS* (1939).

242. See E. STEIN & T. NICHOLSON, *supra* note 237, at 43, 55, 401-03; Stein, *Conflict-of-Laws Rules by Treaty: Recognition of Companies in a Regional Market*, 68 MICH. L. REV. 1327, 1332-33 (1970).

243. See R. KOLLEWIJN, *AMERICAN-DUTCH PRIVATE INTERNATIONAL LAW* 16 (1955); E. RABEL, *supra* note 236, at 67 n.129; E. STEIN, *supra* note 236, at 30-31, 397.

244. Articles 149(1) and 150 of the Swiss Draft of Federal Private International Law provides in principle for the application of the *lex incorporationis*. Certain exceptions in favor of the law of the place of the corporation's business or of the domicile of the claimant apply only to external relations issues such as the agency powers of the corporate officials (Articles 153 and 154). *Message concernant une loi fédérale sur le droit international privé du 10 Novembre 1982*, No. 82.072, at 170-81, 236-40. For a discussion of the earlier version of this Draft, see McCaffrey, *Swiss Conflicts Law*, 28 AM. J. COMP. L. 235, 282-83 (1980).

245. See Hague Convention Concerning Recognition of the Legal Personality of Foreign Companies, Oct. 31, 1951, art. I & II, 40 *Revue Critique de Droit International (Fr.)* 724, reprinted in 1 AM. J. COMP. L. 277 (1952) (law of incorporation is applicable except by a state following the "real

Recognition of Companies,²⁴⁶ adopt the principle of the *lex incorporationis* or its equivalent and allow for the exceptional application of the law of the seat only in certain limited circumstances.²⁴⁷ The "real seat" concept was dealt a major blow in Article 58 of the Rome Treaty creating the European Economic Community.²⁴⁸ It defines the companies entitled to the crucial right of establishment throughout the Community. Under Article 58 it suffices for a corporation organized in accordance with the law of a member state to have "its [formal] registered office . . . within the Community."²⁴⁹ The increasing acceptance of the *lex incorporationis* in Europe is probably due not only to dissatisfaction with the uncertainties and the problems of the "real seat," but also to such other factors as the reduction in economic nationalism and the greater mobility of capital within a free-enterprise system.

Other international texts have accepted in principle the *lex incorporationis*, including the Rules of the Institute of International Law, adopted in 1965,²⁵⁰ and the 1979 Organization of American States Con-

seat" principle, but only if the "real seat" is in fact located in such state or in another "real seat" state).

Article 3 of the French Corporation Law of 1966, which provides that "corporations whose seat is located in France are subject to French Law," has been interpreted in a manner consistent with this exception. In *Comite de defense des actionnaires de la Banque ottomane v. La Banque ottomane* (Trib. Commerce de Paris - 4th Section, Oct. 19, 1982), *reprinted and annotated in* 73 REVUE CRITIQUE DE DROIT INTERNATIONAL PRIVE 98-118 (1984), involving minority shareholder information rights, the court first excluded French substantive law under article 3 because the corporation had its seat outside France, to wit in London. Because England followed the *lex incorporationis*, the court then proceeded to examine the law of Turkey, where the corporation had been organized. Because, however, Turkey followed the seat rule of conflicts, there was a remand to English substantive corporate law which was finally applied! On the *renvoi* aspects of continental conflicts law in this field, see also Coester-Waltjen, *supra* note 236, at 219-20.

246. See 11 J.O. COMM. EUR. (No. L 35) 6 (1968), CONVENTION RELATING TO THE MUTUAL RECOGNITION OF COMPANIES AND LEGAL PERSONS, 2 COMMON MKT. REP. (CCH) ¶ 6255 (1981) (adopting the principle of the registered seat which is the practical equivalent of the place of incorporation; certain exceptions, however, are allowed in articles 3-4: a signatory may declare that it will not apply the Convention if (a) the "real seat" is located outside the Community and the company has no "genuine link with the economy of a member state" and/or (b) the "real seat" is located within its own territory). See also E. STEIN, *supra* note 236, at 406-12; Goldman, *The Convention Between the Member States of the European Economic Community on the Mutual Recognition of Companies and Legal Persons*, 6 COMMON MKT. L. REV. 104, 105-14 (1968).

247. See *supra* notes 245-46.

248. Treaty Establishing the European Economic Community, Office for Official Publications of the European Communities (Luxembourg 1973), *reproduced in* 1 & 2 COMMON MKT. REP. (CCH) (1981).

249. *Id.*, ¶ 1491.

250. 60 AM. J. INT'L L. 523 (1966). Articles 1 and 2 adopt the incorporation principle. Under articles 3-5, however, a state may refuse to recognize a foreign corporation if the "real seat" is located outside the state of incorporation, the articles of incorporation are not in compliance with the law of the "real seat," and either (a) the principal business activities take place outside the state of incorporation or (b) there is no real connection with such state. For a full discussion of these

vention on Conflict of Laws Concerning Companies.²⁵¹

In conclusion, the position of the *lex incorporationis* as a first principle of conflicts remains quite strong around the world²⁵² and also in the United States, where it has been reinforced by the expansive application of the negative commerce clause. But this should not preclude the development of alternatives to or deviations from the rule in exceptional situations to accommodate the strong policies and interests of other states of contact. It is here that the contributions of the new conflicts can be put to best use.

B. *Viable Alternatives to the Lex Incorporationis.*

We must first examine those exceptional situations where a state has such predominant contacts with the internal corporate relationship that its entire law could supercede the law of the state of incorporation. Such a claim does not offend the single-law desideratum and does not lead to fragmentation because the applicable law will purport to provide an alternative rather than a supplementary or deviating regime. Thus, the *Edgar* implications will be attenuated, the question being more of primacy under the full faith and credit clause. This calls for an examination of the "pseudo-foreign" corporation doctrine and of the concept of "domestication."

1. *The Pseudo-Foreign Corporation: Update and Reevaluation.*

a. *The Latty Proposals and the principle of the Mansfield case.*

Professor Latty was an eloquent and persistent critic of the *lex incorporationis* to the extent that it enables a corporation that is local in all essential respects to escape domestic internal affairs law by clothing itself in foreign incorporation papers.²⁵³ Because a state is powerless to prevent its business organizations from obtaining a foreign charter or to prevent other states from issuing such charters, Latty proposed the direct imposition of local law to the "pseudo-foreign" corporation. His proposals provoked widespread discussion but their impact on the courts has

provisions, and comparison with English law, see Drucker, *Companies in Private International Law*, 17 INT'L & COMP. L. Q. 28, 28-57 (1968).

251. Second Inter-American Specialized Conference on Private International Law, Inter-American Convention on Conflict of Laws Concerning Commercial Companies, 18 I.L.M. 1222 (1979). Although no exceptions to the *lex incorporationis* are recognized, it is provided that the state of headquarters may require the corporation to observe the requirements of its own law in a manner which resembles "domestication" (Article 5).

252. For the importance of the *lex incorporationis* in the context of the multinational corporation, see Hadari, *supra* note 45, at 45: "A desirable criterion for determining the applicable personal law could be established by creating a rebuttable presumption which would cause application of the law of the place of incorporation or the registered seat to the internal affairs of foreign corporations."

253. See Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137, 159-62 (1955).

been minor and the only state legislature that considered them—North Carolina's—took no action.²⁵⁴

One of the few but often cited "pseudo-foreign" corporation cases is *Mansfield Hardwood Lumber Co. v. Johnson*.²⁵⁵ The *Mansfield* court did apply local forum law instead of the law of incorporation, but was quite circumspect in delineating the scope of the exception to the internal affairs rule. The corporation was treated as domestic because all contacts other than the "naked fact of incorporation"²⁵⁶ were local. Even in this situation, however, the corporate charter and the non-repugnant statutory laws of the state of incorporation, especially those relating to corporate powers, must be honored.²⁵⁷ Finally, the court based its holding not only on the pseudo-foreignness of the corporation, but also on principles of actionable fraud in the transfer of stock not involving internal affairs.²⁵⁸

Another case in the *Mansfield* mold, involving a notorious intrafamily dispute relating to the *Chicago Tribune*, is *Tankersley v. Albright*.²⁵⁹ A majority of the stock of the company, originally an Illinois corporation that later migrated to Delaware, was held in trust under an instrument executed in Illinois.²⁶⁰ The assets and administration of the trust as well as the headquarters and principal place of business of the *Chicago Tribune* were located in Illinois.²⁶¹ The trustees sought a declaratory judgment confirming their authority to vote the shares in favor of certain antitakeover amendments.²⁶² The court, applying Illinois instead of Delaware law in accordance with the "most significant relationship" test of the *Restatement (Second)*, upheld the validity of the voting trust. In view of the Illinois contacts,²⁶³ the mixed corporate-contractual nature of the conflicts question involved, and the fact that neither the

254. See Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432. For a fuller explanation, see, Latty, Powers & Breckenridge, *The Proposed North Carolina Business Corporation Act*, 33 N.C. L. REV. 26 (1954).

255. 268 F.2d 317, 318 (5th Cir. 1959) (per curiam) (involving the fiduciary obligations of corporate management and majority shareholders in the purchase of minority stock), *cert. denied*, 361 U.S. 885 (1960); cf. *Blazer v. Black*, 196 F.2d 139 (10th Cir. 1952) (where the law of Kansas, the state of principal business and of the location of the alleged breaches of fiduciary duty, was applied to a similar issue over the law of Illinois, the state of incorporation, but without any explanation or discussion of choice of law).

256. *Mansfield*, 268 F.2d at 321. Such contacts included residence of parties, situs of property, principal place of business and disputed transaction.

257. *Id.*

258. *Id.* at 321-22.

259. 374 F. Supp. 538 (N.D. Ill. 1974).

260. *Id.* at 540.

261. *Id.* at 550.

262. *Id.* at 539-42.

263. *Id.* at 550.

trust nor the corporation had any meaningful connection with Delaware, the decision appears sound.

This narrow "pseudo-foreign" corporation exception which allows for the enforcement of the mandatory policies and interests of the *only* state of real contacts is an appropriate deviation from the general rule.²⁶⁴ The same is true for the "pseudo-foreign" aspects of *Western Air Lines* and *State ex rel. Weede*.²⁶⁵ In these situations there is little risk of uncertainty or of the kinds of extraterritorial burdens or conflicts outlawed in *Wolfe* and *Edgar*.²⁶⁶

b. *The status of the California regulation of the internal affairs of California-centered corporations.* The 1977 amendments to the Corporation Law of California present a more difficult issue.²⁶⁷ Under section 2115, California law applies to virtually the entire gamut of internal affairs of a foreign corporation, to the exclusion of the law of the state of incorporation, if (a) the majority of stock is held in California and is not traded over a national securities exchange *and* (b) at least fifty percent of the corporation's "business"—measured by averaging payroll, assets and sales—is connected with California.²⁶⁸ The California approach represents the most serious current challenge to the *lex incorporationis*; it is likely to test the internal affairs implications of *Edgar* even though section 2115 applies only to enterprises that in every business and ownership respect have predominant, not only substantial, California contacts. Even before *Edgar* was decided, the California approach had been controversial and the commentators were divided on its constitutionality. What is remarkable about this pre-*Edgar* discussion is the prescient shift from a full faith and credit and due process rationale to an interstate

264. For favorable comments on *Mansfield*, see, for example, Kaplan, *supra* note 1, at 452-53. See also Sargent, *supra* note 53, at 16-22 (strongly reaffirming this exception). Its holding also appears consistent with the RESTATEMENT (SECOND), *supra* note 46, § 302 comment g (allowing exceptional application of the law of the state of the "dominant interest").

265. See *supra* notes 161-62, 189-94 and accompanying text.

266. See generally Oldham, *Regulating the Regulators: Limitation Upon a State's Ability to Regulate Corporations with Multi-State Contacts*, 57 DEN. L.J. 345, 364-70, 375-79, 389-92 (1980) (arguing for the adoption of "pseudo-foreign" corporation laws as "a means by which certainty can be retained in the corporate choice of law while allowing the commercial domicile to regulate internal affairs of corporations in more instances").

267. Act of July 7, 1977 ch. 235, sec. 19, 1977 Cal. Stat. 1073 (adding CAL. CORP. CODE § 2115).

268. CAL. CORP. CODE §2115 (West 1977). California has a long history of looking behind the veil of foreign incorporation to curb serious abuses, see Note, *California's New General Corporation Law: Quasi-Foreign Corporations*, 7 PAC. L.J. 673, 678-84 (1976), and section 2115 was intended to prevent evasion of the substantive strictures enacted in 1977. See *Major Changes in the California Corporation Law: Hearings on A.B. 376 before the Assembly Committee of the Judiciary*, Cal. Leg., 1975-76 Reg. Sess. 4 (statement of H. Marsh, Jr.). It was in California, one should remember, that the authority of the local state to penetrate the internal affairs of a foreign corporation had been judicially upheld in *Western Air Lines*. See *supra* notes 189, 191 and accompanying text.

commerce theory.²⁶⁹ The critics attacked the use of criteria that fluctuate from year to year and produce such uncertainties and lack of uniformity as to outweigh California's interest in the protection of local shareholders.²⁷⁰ Subjecting multistate corporations to varying internal affairs laws depending on changing business contacts opens the door to interstate chaos.²⁷¹ The supporters emphasized the significance of the local contacts used and the weight of the related policies and concluded that not only did they justify the incidental burdens placed on interstate commerce but they also satisfied any due process and full faith and credit requirements.²⁷²

The first case to consider the issue, *Louart v. Arden Mayfair*,²⁷³ involved the imposition of cumulative voting on a Delaware corporation that was not a pure "tramp," but had significant out-of-state contacts as well. In holding section 2115 unconstitutional, the lower court stressed the need for a single uniform standard of corporate governance, and concluded that the "uncertainties and the vagaries of potential fluctuations from year to year . . . in the election of directors"²⁷⁴ was incompatible with full faith and credit and constituted an impermissible burden on interstate commerce under *Bibb v. Navajo Freight Lines, Inc.*²⁷⁵ and under the Horowitz analysis.²⁷⁶ There was an appeal but the case was eventually settled.²⁷⁷

The constitutionality of section 2115 as it applies to cumulative voting was recently upheld at the appellate level in *Wilson v. Louisiana-Pacific Resources, Inc.*²⁷⁸ The corporation clearly fell within the statutory requirements. It had no significant connection with Utah, the state of incorporation; California was its principal place of business, where all its employees were located, and where the meetings of directors and

269. This was principally due to the Horowitz article mentioned *supra* note 187.

270. See, e.g., Comment, *California's Statutory Attempt to Regulate Foreign Corporations: Will It Survive the Commerce Clause?*, 16 SAN DIEGO L. REV. 943, 954-57 (1979).

271. See *id.* at 959-61.

272. See, e.g., Oldham, *California Regulates Pseudo-Foreign Corporations—Trampling Upon the Tramp?*, 17 SANTA CLARA L. REV. 85, 110-23 (1977); Ratner & Schwartz, *supra* note 167, at 664-69 (1979); Note, *supra* note 268, at 693-98.

273. No. C-192-091 (Sup. Ct. of Los Angeles County, May 1, 1978), discussed in H. MARSH, MARSH'S CALIFORNIA CORPORATION LAW § 24.17 (1981).

274. *Id.*

275. 359 U.S. 520 (1959).

276. See *supra* note 187.

277. See Comment, *supra* note 270, at 957. The impact of *Louart* is weakened by a dictum in a later proceeding in the same case before settlement that dissenters' rights do not fall within the single-law principle and section 2115 may apply to them. See H. MARSH, *supra* note 273, § 24.17.

278. 138 Cal. App. 3d 216, 187 Cal. Rptr. 852 (1982). For a critical discussion of this case, see Ginger, *Regulation of Quasi-Foreign Corporations in California: Reflections on Section 2115 After Wilson v. Louisiana-Pacific Resources, Inc.*, 14 SW. U. L. REV. 665-83 (1984).

shareholders had been taking place.²⁷⁹ Relying principally on *Allstate*, the court experienced no difficulty in turning down the full faith and credit and due process challenges: Section 2115 is valid because it applies only to corporations with significant—and predominant—contacts with California.²⁸⁰

The commerce clause issue, however, was a different matter. Without taking notice of *MITE*, the court considered and rejected three arguments that the statute impermissibly burdened interstate commerce. First, the court found no evidence that section 2115 had deterred foreign corporations from increasing their in-state business activities in order to avoid California's internal affairs law.²⁸¹ But the reduction of in-state business surely is not the only way in which interstate commerce may be burdened. Extraterritorial control of internal affairs suffices under *Wolfe* and *MITE*. Next, the court was unpersuaded by the argument that the "transient nature" of the statute's applicability would significantly restrain commerce.²⁸² Responding to the central problem of uncertainty and confusion and the potential conflict with the laws of other states, especially that of the state of incorporation,²⁸³ the court first cited Professor Kaplan's 1968 article²⁸⁴ to the effect that imposing on corporate internal affairs dual or variable sets of rules need not produce conflict, but only compatible cumulation.²⁸⁵ Subjecting the plaintiff to cumulative voting does not create a conflict with Utah because Utah permits such a procedure; interstate commerce, therefore, is not burdened.²⁸⁶ This part of the *Wilson* reasoning is equally unpersuasive. Conflict arises not only when what one state requires, the other prohibits, but also when one state

279. *Wilson*, 138 Cal. App. 3d at 220-21, 187 Cal. Rptr. at 855.

280. *Id.* at 222-23, 187 Cal. Rptr. at 857. In addition to *Allstate*, the court relied for its full faith and credit holding on *Alaska Packers Ass'n v. Industrial Accident Comm'n*, 294 U.S. 532, 547 (1935), and on the *Western Air Lines* language about pseudo-foreign corporations. *Wilson*, 138 Cal. App. 3d at 222-23, 187 Cal. Rptr. at 856-57. The court took the position that *Broderick v. Rosner*, 294 U.S. 629 (1935), which had mandated the application of New York law as *lex incorporationis* to shareholder assessments, not only was obsolete but also distinguishable because in that case New Jersey, the only other potentially interested state where the resisting shareholders resided, had no declared policy against such recovery. *Wilson*, 138 Cal. App. 3d at 224, 187 Cal. Rptr. at 856-58. The converse was the case in *Wilson*. *Id.* As to due process, the court easily brought the facts within the shelter of *Allstate* and its predecessors. *Id.* at 228-29, 187 Cal. Rptr. at 861. A contract clause argument was also summarily dismissed. *Id.* at 229, 187 Cal. Rptr. at 862.

281. *Id.* at 226, 187 Cal. Rptr. at 859.

282. *Id.*

283. *Id.* at 226-28, 187 Cal. Rptr. at 858-61.

284. Kaplan, *supra* note 1, at 476-77.

285. *Wilson*, 138 Cal. App. 3d at 226, 187 Cal. Rptr. at 859-60.

286. *See id.* at 223, 187 Cal. Rptr. at 857. For a similar position on probable compatibility satisfying full faith and credit in a case involving the inspection of shareholder lists under CAL. CORP. CODE § 1600 (West 1977), see *Valtz v. Penta Inv. Corp.*, 139 Cal. App. 3d 803, 808, 188 Cal. Rptr. 922, 925 (1983), discussed *infra* notes 343-49 and accompanying text.

imposes a mandatory standard while another applies a permissive policy which allows the shareholders to decide whether to adopt the standard. Patching together a composite set of compatible rules drawn from the laws of the various states of contact not only is problematical in execution, but also upsets the unity of regulation under a single set of standards and maximizes the extraterritoriality of the strictest alternative.

The reference in *Edgar* to the burdens of multiple regulation includes difference and is not limited to incompatibility. Compliance with the Illinois statute would not have violated the law of any other state, but the opinion makes no reference to a direct conflict as a prerequisite to a commerce clause challenge. This interpretation is consistent with the perception of what constitutes a "burden" in other types of commerce cases.²⁸⁷ The court used a more solid ground—not a disclaimer of burdensomeness but a claim of right—for the second part of its decision. A corporation meeting the requirements of section 2115 is so closely connected with California that "no other state could claim as great an interest in [regulating shareholder voting]."²⁸⁸ Regardless of the effects on interstate commerce, California can apply its internal affairs law to it not only in California but everywhere else to the exclusion of the law of incorporation.²⁸⁹

The constitutionality of section 2115 will probably be challenged again and eventually may reach the United States Supreme Court. The chances of its passing the tests of *Wolfe* and *Edgar* are reasonably good. The exclusion of corporations the stock of which is nationally traded, and the use of criteria that cover only corporations the affairs of which in every significant respect are centered in California, narrow the applicability of the statute to corporations that are predominantly local not only as to operations, but also as to shareholdings for which no other state can claim a superior or even a comparable right. But making amendments along the lines suggested by some commentators—increasing the local shareholding requirement to seventy or eighty percent, eliminating from coverage certain issues where the problem of a significant conflict with other states is greatest, and reducing the annual switching-back-and-forth feature²⁹⁰—would place it comfortably beyond challenge.

287. See *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 781-82 (1969) (state regulation of train lengths passes beyond what is plainly essential for safety and is outweighed by the interest of the nation in an adequate, economical, and efficient railway transportation service).

288. *Wilson*, 138 Cal. App. 3d at 227, 187 Cal. Rptr. at 860.

289. *Id.* at 231, 187 Cal. Rptr. at 863; see also *id.* at 223 n.4, 187 Cal. Rptr. at 857 n.4 (citing Justice Stevens' interpretation of full faith and credit in *Allstate*).

290. See Bartell, *supra* note 172, at 809; Halloran & Hammer, *Section 2115 of the New California General Corporation Law—The Application of California Corporations Law to Foreign Corporations*, 23 UCLA L. REV. 1282, 1328-32 (1976).

As the state of dominant contacts with an interest in effectuating its internal affairs policies, California would amply meet all requirements imposed by even the most conservative of the new conflicts theories for the total application of its law to the exclusion of the law of incorporation. Other states that have adopted a "significant" or even a "most significant" relationship conflicts approach may decide to honor California's exclusive claim.²⁹¹ The more difficult question is whether they are required to do so under the full faith and credit clause or under the commerce clause. It can be argued that the constitutional underpinnings of a uniform, constant, and equal regime should extend to whatever other law is chosen as the proper law of a particular corporation²⁹² and that, in extreme cases, the application of the *lex incorporationis* itself over the law of the state of all contacts may raise constitutional questions.²⁹³

2. *Mandating "Domestication" or Local Incorporation for Intrastate Operations.* In the past, some states required "domestication"—subjection to local law for the intrastate operations particularly of certain public interest enterprises²⁹⁴—and that practice is supported by constitutional precedent.²⁹⁵ Some states, such as Pennsylvania, still have in their statutes seldom-used provisions permitting domestication.²⁹⁶ It has been suggested that this approach, which does not directly regulate internal affairs but only excludes foreign corporations from intrastate business unless they either "qualify" as domestic corporations, or set up a domestic subsidiary, is consistent with *Wolfe* and the full faith and credit clause, at least when the corporate business is centered in the state. Important local interests are served without generating legal uncertainty as

291. A more intriguing question is whether California will recognize comparable claims made by other states for corporations centered in them. Section 2115 does not address this question because it is purely unilateral. Other sections, such as CAL. CORP. CODE § 2116 (West 1977) which enforces certain liabilities of directors of foreign corporations conducting intrastate business, refer to the "applicable laws of the state of incorporation."

292. See Horowitz, *supra* note 187, at 820.

293. See B. CURRIE, *The Constitution and Choice of Law*, *supra* note 153, at 188, 252.

294. See Kaplan, *supra* note 1, at 444-45.

295. See *Watson v. Employers Liab. Assurance Corp.*, 348 U.S. 66, 73-74 (1954) (Frankfurter, J., concurring) ("Louisiana has a constitutional right to subject foreign liability insurance companies to the direct action provisions of its laws whether they consent or not"); *Railway Express Agency, Inc. v. Virginia*, 280 U.S. 440, 444 (1931) (provision of Virginia constitution forbidding any foreign corporation to carry on the business of a public service company, intrastate, does not impose a burden on interstate commerce and is presumed to be constitutional); see also *Home Ins. Co. v. Dick*, 281 U.S. 397, 410 (1930) ("[A] state may properly refuse to recognize foreign rights which violate its declared policy.").

296. 15 PA. CONS. STAT. ANN. § 909 (Purdon 1964).

to the applicable internal affairs law.²⁹⁷

Domestication as a condition of doing local business is a powerful tool that can be quite effective in preventing the "Delawarization" of the local component of corporate activity. Indeed, it should be the preferred tool of intervention in terms of certainty, limited effect, and direct connection to local corporate policy. The field of conflicts will readily recognize the validity of an express state claim to regulate the form, structure, and internal relations of entities owning local resources or engaging in local activities. Great care should be exercised, however, to use it in ways that do not impose unconstitutional conditions on entry and do not interfere with or burden interstate operations.²⁹⁸ Furthermore, domestication should be tied to domestic operations and not used as a lever to subject to local law the entire internal affairs of locally-connected foreign corporations.

If, as is likely, a national corporation will choose to set up a local subsidiary rather than domesticate itself, the application of the total domestic internal affairs law to the local assets and activities will be achieved. This would include the imposition of the domestic fiduciary standards and other controls on the parent as a shareholder and de facto manager. To be sure, the local shareholders of the parent would not be covered, but this is consistent with the local-business and assets focus of domestication as well as with the constitutional prohibition against protecting resident shareholders through excessive interference in the internal affairs of genuinely foreign corporations.

If a state were committed to extend its law to the local shareholders of all foreign corporations having local connections, it could use its blue-sky power to exclude from intrastate sales the securities of those corporations whose internal affairs regimes did not meet the domestic standards. This would of course minimize local shareholding. Perhaps it could also go so far as to impose substantial local shareholding requirements on all domestic corporations, but the drastic negative effect of such a step on attracting foreign business makes such an eventuality extremely remote.

297. See Coffee & Schwartz, *supra* note 134, at 332-33; Gibson & Freeman, *A Decade of the Model Business Corporation Act in Virginia*, 53 VA. L. REV. 1396, 1412-13 (1967); Kaplan, *supra* note 1, at 445.

298. See *Terral v. Burke Constr. Co.*, 257 U.S. 529, 532 (1922) (state law which permits the revocation of a license of a foreign corporation to do business within the state because the corporation, while doing domestic business, resorts to a federal court sitting in the state, is unconstitutional); Hale, *Unconstitutional Conditions and Constitutional Rights*, 35 COLUM. L. REV. 321, 337 (1935) (states' power to exclude foreign corporations is limited by the requirements that the surrender of a constitutional right "serves a purpose germane to that for which the power can normally be extended without conditions" and that there be "no undue interference with the workings of the federal system").

C. *Deviations From the Lex Incorporationis to Protect Important Local Interests.*

1. *The Different Categories of Internal Affairs and Local Corporate Policy.* The constitutional and conflicts considerations that support the primacy of the lex incorporationis and the single-law principle militate against piecemeal intervention into the internal affairs of a foreign corporation except when intervention is absolutely necessary to effectuate an important local policy and when intervention is minor and non-disruptive. Even those most intensely concerned with local control of corporate policy concede the validity of this view.²⁹⁹ The *Restatement (Second)* quite appropriately uses such words as “unusual”³⁰⁰ and “overriding interest of another state”³⁰¹ to refer to the situation where the law of incorporation—which is “almost invariably” applied³⁰² and of “great significance”³⁰³—may be circumvented. Consequently, the test of the “most significant relationship to the occurrence and the parties” used by the *Restatement (Second)*³⁰⁴ must be read in the context of the hostility with which any interference is viewed in this field. It should not mislead one to engage in simple balancing of contacts and interests on an issue-by-issue or party-by-party basis.

Certain internal affairs matters are even less amenable to differential treatment than others. The hard core areas where “indivisible unity” is paramount should include first and foremost the rights that attach to corporate shares: voting, obtaining information, inspecting corporate records, and dividends, as well as rights in dissolution and liquidation and in corporate consolidations such as mergers. Other shareholder matters, such as the validity of stock issues, assessments on or redemptions of shares, fiduciary obligations, protection of minority rights, transfer restrictions, and the validity of shareholder agreements and voting trusts also fall within this category. It is here that the considerations of predictability, constancy, and autonomy are strongly reinforced by the requirement of equal treatment.³⁰⁵ In addition, there are overwhelming

299. The most articulate proponent of local corporate policy, Professor Kaplan, writes that, in the absence of a statutory directive, there should be great circumspection and restraint on the part of the courts in giving effect to local corporate public policy; interventions into the affairs of a genuine foreign or national corporation, he maintains, generally are not justified. See Kaplan, *supra* note 1, at 475.

300. RESTATEMENT (SECOND), *supra* note 46, at § 302(2).

301. *Id.* at § 302 comment g.

302. *Id.*

303. *Id.* at § 302 comment b.

304. *Id.* at § 302(1).

305. See *id.* at § 302(2) comments e & f; Reese & Kaufman, *supra* note 1, at 1124-26, 1134, 1137-39, 1141-43.

practical reasons why corporate formation, governance, structure, and procedures need to be governed by unitary law.³⁰⁶

The argument for applying the *lex incorporationis* to management's fiduciary obligations to the corporation and to the shareholders is less compelling. The imposition of the strictest of the potentially applicable standards does not create serious practical problems because it is relatively easy for the fiduciaries to learn about applicable rules and to conform to them. Shareholder equality is also not directly implicated. The greater flexibility in this area is recognized by the *Restatement (Second)* which does not include in section 309 the "unusual situation" qualification of the other sections to justify departure from the *lex incorporationis*.³⁰⁷ This aspect of section 309 has been recognized in at least two recent cases where the law of another state was chosen.³⁰⁸ As between the state of the residence of the shareholders and that of corporate business, the former should have a superior claim because the ultimate beneficiaries of management's fiduciary duties are the shareholders.

In certain contexts the internal affairs characterization is so tangential or dubious that unitary treatment easily can be eliminated. The contractual aspects of a voting trust agreement, for example, may be subjected to the formal and substantive requirements of the law chosen under contract conflicts rules.³⁰⁹ Similarly, the non-corporate aspects of proxies³¹⁰ may be treated as involving issues in contract. The contract and property aspects of transfers of securities similarly need not be referred to the law of the state of incorporation.³¹¹

Another more problematical category encompasses certain corporate rules that both significantly affect creditor rights as well as regulate the internal relationship. This category includes the *de facto* corporation and *ultra vires* doctrines, piercing the corporate veil, the liability of successor corporations, the personal liability of managers for corporate torts, and the prohibitions against the distribution of corporate assets—such as loans, dividends, stock and repurchases—to shareholders or

306. See RESTATEMENT (SECOND); *supra* note 46, § 302(1).

307. *Id.* at § 309 & comment c.

308. See *Ficor, Inc. v. McHugh*, 639 P.2d 385, 391 (Colo. 1982) (District of Columbia corporation had some officers, directors, and shareholders residing in the District, but all business and assets were in Colorado; relationships in dissolution between directors and shareholders on the one hand and creditors on the other were determined by Colorado law); *Francis v. United Jersey Bank*, 162 N.J. Super. 355, 368-69, 392 A.2d 1233, 1240 (Law Div.) (New York corporation had no significant contacts in state of incorporation, while New Jersey was the place of basic operations of the corporation, residence of all shareholders and payees of funds, location of transactions; New Jersey law applies to liability of directors), *aff'd*, 171 N.J. Super. 34, 407 A.2d 1253 (1978).

309. See RESTATEMENT (SECOND), *supra* note 46, § 305 comment b.

310. See *Reese & Kaufman*, *supra* note 1, at 1124-25.

311. *Id.* at 1134.

managers in certain instances. Although the *Restatement (Second)* fails to single out this category for special treatment, a good case can be made that the state where the corporation conducts business may have a more "significant relationship," at least where the rights are asserted by resident creditors and relate to local transactions.³¹² An examination of the few cases that have articulated a choice in these contexts reveals that while the *lex incorporationis* is not totally ignored, there is some recognition of the importance of taking account of local protective policy.³¹³

In other situations where creditors sought to pierce the corporate veil to impose personal liability on insiders, however, courts applied the *lex incorporationis* without much discussion.³¹⁴ The rights of creditors to the corporate assets in insolvency proceedings have been determined under the *lex incorporationis* because of the desirability of uniform treatment.³¹⁵

312. See *id.* at 1139-41; see also Article 9 of the Rules adopted by the Institute of International Law, 60 AM. J. INT'L 523 (1966), providing that the state where a corporation has a place of business may (a) require the appointment of a local representative who shall have the powers and duties of corporate management under local law; (b) impose financial obligations for the protection of creditors; and (c) liquidate the local assets in the interest of creditors); Coester-Waltjen, *supra* note 236, at 221-22.

313. In *Loveridge v. Dreagoux*, 678 F.2d 870 (10th Cir. 1982), the court applied the law of Utah where the sale of certain debentures had taken place and where all the corporate business was conducted, to the question of whether the incorporator, president, and secretary of a purported Nevada corporation, later formally organized in Nevada, was personally liable on its obligations as a promoter. The court opined that Utah had a significant interest in protecting the rights of its citizens in these circumstances. *Id.* at 878. It conceded that Nevada law should govern the question of whether and when the Nevada corporation was formed, and emphasized that the liability of the promoter involved fraud to third parties and was not really an internal matter. *Id.* at 877-78. Similarly, in *Clarkson Co. v. Shaheen*, 660 F.2d 506, 512 n.4 (2d Cir. 1981), the law of New York—where the corporate headquarters were located, many transactions took place, and several creditors resided—was applied to determine the validity of certain loans at a time when a Canadian corporation was insolvent. In *Shingleton v. Armor Velvet Corp.*, 621 F.2d 180, 181 (5th Cir. 1980), Georgia law was applied to the issue of the personal liability of certain corporate officers of an Alabama corporation who took part in the commission of a tort in Georgia. In *Litarowich v. Wiederkehr*, 170 N.J. Super. 144, 151-52, 405 A.2d 874, 877-78 (Law Div. 1979), the liability of a successor corporation for tort claims was determined under tort criteria and interest analysis, without deference to the law of incorporation of the entities involved.

314. See *Edwards Co. v. Monogram Indus.*, 713 F.2d 139, 140 (5th Cir. 1983) ("[T]he facts set forth in the panel opinion constitute sufficient compelling factors, as required by Texas law, to require piercing [the] veil."); *Bucyrus-Erie Co. v. General Prods. Corp.*, 643 F.2d 413, 418 n.3 (6th Cir. 1981) (law of state of incorporation controls in diversity actions) (citations omitted). In *Jefferson Pilot Broadcasting Co. v. Hilary & Hogan, Inc.*, 617 F.2d 133, 135 (5th Cir. 1980), the court applied the *lex incorporationis* because Alabama continues to adhere to the traditional conflicts rules. In *K. Mart Corp. v. Knitjoy Mfg.*, 542 F. Supp. 1189, 1190 n.2 (E.D. Mich. 1982) and *DuSesoi v. United Ref. Corp.*, 540 F. Supp. 1260, 1265-66 (W.D. Pa. 1982), the courts dodged the issue by finding that the two potentially applicable laws were not materially different.

315. See, e.g., *Jump v. Goldenhersh*, 619 F.2d 11, 14, 15 n.4 (8th Cir. 1980) (substantive law of corporation's state of incorporation applies to determine which payments to creditors are voidable under preferred payment statute).

2. *Limited Interventions in New York and California.* The most noteworthy example of limited but nevertheless substantial intervention in the internal affairs of foreign corporations is that of New York where statutory rules, in effect since the beginning of the century, impose liability on the management of foreign corporations for unlawful dividends, loans to certain shareholders, false certificates, and transfers in fraud of creditors.³¹⁶ For many years the courts applied these rules to all corporations that had a "substantial business" connection with New York, regardless of the location of the other corporate contacts.³¹⁷ In 1961, the New York Business Corporation Law introduced the new concept of the "domiciled foreign corporation," and subjected it to extensive internal affairs regulation.³¹⁸ "Domicile" was based on either two-thirds shareholdings by New York residents or two-thirds of income allocable to New York.³¹⁹ But this concept was dropped very quickly as impractical and too extensive.³²⁰

In fact, it became quickly apparent that the pressures were in the opposite direction: to limit New York interference by requiring a "majority" and not just a "substantial" business connection with New York.³²¹ In the legislation enacted in 1963, not only was the applicability

316. See N.Y. STOCK CORP. LAW § 114 (McKinney 1940); N.Y. GEN. CORP. LAW §§ 60-61, 224 (McKinney 1943) (current version at N.Y. BUS. CORP. LAW §§ 719, 1317(a)(1) (McKinney 1963)); see also *Irving Trust Co. v. Maryland Casualty Co.*, 83 F.2d 168, 170 (2d Cir. 1936). Before the enactment of these sections in the 1890's, New York courts applied the law of incorporation across the board. See, e.g., *Lancaster v. Amsterdam Improvement Co.*, 140 N.Y. 576, 590-93, 35 N.E. 964, 968-69 (1894); *Vanderpoel v. Gorman*, 140 N.Y. 563, 567, 35 N.E. 932, 936 (1894); *Demarest v. Flack*, 128 N.Y. 205, 215, 28 N.E. 645, 648-50 (1891).

317. See *International Ticket Scale Corp. v. United States*, 165 F.2d 358, 359-60 (2d Cir. 1948); *Irving Trust Co. v. Maxwell*, 56 F.2d 744, 747 (2d Cir. 1932); *International Paper Co. v. United States*, 88 F. Supp. 891, 895 (Ct. Cl. 1950); *German American Coffee Co. v. Diehl*, 216 N.Y. 57, 60, 109 N.E. 875, 877 (1915).

318. N.Y. BUS. CORP. § 1317 (McKinney Supp. 1962) (repealed by Act of Apr. 24, 1962, § 96, 1962 N.Y. Laws 3569, 3604).

319. *Id.* See Henn, *The Philosophies of the New York Business Corporation Law of 1961*, 11 BUFFALO L. REV. 439, 455 n.109 (1962); Latty, *Some General Observations on the New Business Corporation Law of New York*, 11 BUFFALO L. REV. 591, 610-11 (1962).

320. Act of Apr. 24, 1962, § 96, 1962 N.Y. Laws 3569, 3604. See Note, *Corporations: Domestic Regulation of Foreign Corporations: Concept of "Domiciled Foreign Corporation": New York Business Corporation of 1961*, 47 CORNELL L.Q. 273, 285 (1962) (predicting that the attempt to define a "domiciled foreign corporation" would lead to "complicated problems of interpretation and application").

321. See Draft of Joint Legislative Committee, N.Y. Sen. Int. Pr. 522; Pr. 855 (Jan. 4, 1961). The New York bar supported the traditional rule of incorporation and generally opposed any interference in the internal affairs of foreign corporations. See *Report on NYBCL, Committee on Corporation Law, NYSBA*, 33 N.Y.S. BAR R. 442 (Dec. 1961); *Preliminary Report of the Association of the Bar of the City of New York, Committee on Corporate Law of the NYBCL (1961): First Interim Report to 1957 Session of New York State Legislature*, N.Y. Leg. Doc. No. 17 at 41, 47, 85-86, 91 (1957).

of the rules relating to unlawful dividends and loans narrowed,³²² but the legislation also provided that only corporations that derive more than one-half of their income from New York and whose shares are not listed on a national securities exchange would be covered.³²³ This retreat was prompted by criticisms concerning (a) the uncertainty of what quantum of business triggered the regulation, (b) the potential for conflicts between domestic and foreign law, and (c) the discouraging effects of prior law upon bona fide foreign corporations doing business in New York.³²⁴ Thus, the end result of the 1963 reform was to strengthen and expand the applicability of the *lex incorporationis*.³²⁵

Nevertheless, the question remains whether the extraterritoriality, however limited, of the New York statute is constitutionally valid and represents proper conflicts doctrine. Early doubts concerning the validity of the pre-1963 New York rules under the full faith and credit clause had been raised by Reese and Kaufman.³²⁶ The issue now deserves serious reexamination under *Edgar*. The required New York connection—the derivation of more than one-half of the income of the corporation from New York sources—does not make the corporation in all essential respects local, and is a slender reed to support general authority to regulate internal affairs. Excluding corporations the shares of which are nationally traded is not enough to cure the problem. The New York intervention can be saved only because of (a) its narrow coverage—management responsibility for certain financial actions depleting corporate assets, (b) New York's interest in protecting the persons likely to be injured by such actions—local creditors, (c) the use of a reasonable connecting factor—such as a source of a majority of income—between coverage and the narrow interest assessed, and (d) the nature of the regulation—strengthening liability of management is not apt to produce an intractable conflict with the internal affairs law of the corporation because it does not interfere with structures nor does it lead to unequal treatment of the shareholders. Thus, it may be argued that the New York intervention should survive the balancing test of the commerce

322. See, e.g., N.Y. BUS. CORP. LAW § 719, 1317(a)(1) (McKinney 1963) (which eliminated certain liabilities of shareholders and reduced the liability of officers).

323. See N.Y. BUS. CORP. LAW § 1320 (McKinney 1963).

324. The background and details of the changes are discussed in Heun, *supra* note 319, at 439-59; Latty, *supra* note 319, at 593-612.

325. The new law's principal retrogression is its recognition of the old "concession theory" with respect to the foreign corporation, viz., that it is a creature of the law of its state of incorporation and should, even when doing business in New York with New York residents, be governed, so far as regulatory aspects are concerned, by the law of its state of incorporation and not by New York law.

Henn, *supra* note 319, at 451.

326. See Reese & Kaufman, *supra* note 1, at 1129.

clause and should be upheld under the conflicts criteria against overreaching; it is relatively minor, non-disruptive, and genuinely protective of local interests. This argument may not be frivolous, but neither is it very compelling.

A similar argument can be made in favor of the statutory provisions that apply the stricter New York law to limit the indemnification and insurance of directors and officers of foreign corporations.³²⁷ Controlling such "malpractice" protection may have a deterrent effect on actions that have local impact. Potential conflicts with the law of incorporation are reduced by a provision that no indemnification shall be made if inconsistent with the law of incorporation.³²⁸ On the other hand, the connecting factor used, majority of income from New York sources,³²⁹ appears overinclusive.

In addition to strengthening management responsibility for unlawful outlays and false reports, and controlling indemnification and insurance, New York also extends certain other rules to foreign corporations doing any business in the state. It is difficult to detect a common thread running through all of these exceptional applications of New York corporate law. The concern over burdening the courts with frivolous litigation may justify and explain, under a procedural characterization, the imposition of New York's rather strict requirements, including security for expenses, to derivative actions in New York.³³⁰ This explanation is supported by the inclusion of corporations the shares of which are traded on the exchanges and which do not derive the majority of their income from New York,³³¹ but is undercut by the exclusion of foreign corporations not doing business in New York.³³² Voting trusts in shares of foreign corporations having business offices in New York *and* conducting their principal business operations or having the greater part of their property in New York are treated as "express trust[s] created under [New York

327. See N.Y. BUS. CORP. LAW §§ 721-727, 1319(a)(4) (McKinney 1963).

328. See N.Y. BUS. CORP. LAW § 726(b)(1) (McKinney 1963). *But see* N.Y. BUS. CORP. LAW § 727(e) (McKinney 1963) (declaring the insurance provisions of the law to be applicable as a matter of public policy to the exclusion of any other law).

329. N.Y. BUS. CORP. LAW §§ 726(d), 1320(a)(2) (McKinney 1963).

330. N.Y. BUS. CORP. LAW §§ 626, 627, 720, 1317(a)(2)-(b), 1319(a)(2)-(3) (McKinney 1963); *see also* *Shielcrawt v. Moffett*, 184 Misc. 1074, 56 N.Y.S.2d 134 (Sup. Ct. 1945).

331. N.Y. BUS. CORP. LAW § 1320(a) (McKinney 1963).

332. N.Y. BUS. CORP. LAW § 1319(a)(2)-(3) (McKinney 1963) calls for the application to foreign corporations "doing business in [New York]" of the sections on derivative actions "to the extent provided therein." *See also* N.Y. BUS. CORP. LAW §§ 626-627 (McKinney 1963). Those sections by their terms apply to all domestic and foreign corporations but the courts have properly superimposed the more narrow coverage of section 1319 and exclude corporations not doing business in New York. *See, e.g.,* *Oldfield v. Alston*, 77 F.R.D. 735, 746 (N.D. Ga. 1978); *Gilbert v. Case*, 3 A.D. 2d 930, 163 N.Y.S.2d 179 (Sup. Ct. 1957).

law]" and subject to the jurisdiction of the New York courts.³³³ It is doubtful that this language brings into application the corporate law rules relating to voting trusts. Thus, this provision may be characterized as procedural—pertaining to the administration of the trusts—rather than as an element of internal corporate affairs.

The last category of New York interventions empowers "resident" shareholders of foreign corporations to inspect shareholder lists³³⁴ and voting trust records³³⁵ and to demand certain reports on capitalization and distributions.³³⁶ These provisions are applicable also on the basis of the corporation's "doing business" in New York.³³⁷

Inspection of shareholder lists under local law rather than under the *lex incorporationis* has not been unknown in case law³³⁸ and is statutorily imposed also in California on foreign corporations that have their principal offices or customarily hold board meetings in the state.³³⁹ A state presumably has the power to reach physical assets such as shareholder records within its borders. It might be argued that the application of local inspection law involves no direct extraterritoriality, imposes no conflicting obligations, and can be easily complied with by the corporation.³⁴⁰ Thus, the burden on interstate commerce is insignificant. On the other hand, treating shareholder lists as assets is simplistic and mistaken. The inspection is a prelude to intershareholder communication in the context of corporate governance and thus is clearly within the realm of internal affairs;³⁴¹ the required nexus of the corporation in New York and in California bears little relation to such communication. This is not merely opening the local courts to inspection suits but calls for the application of local substantive law as well. Not surprisingly, the tactical advantages of using the New York provisions to bypass the standards of the state of incorporation are already being discovered by takeover and proxy fight specialists.³⁴²

333. N.Y. BUS. CORP. LAW § 1316(e) (McKinney 1963).

334. N.Y. BUS. CORP. LAW § 1315 (McKinney 1963).

335. N.Y. BUS. CORP. LAW § 1316(a)-(d) (McKinney 1963).

336. N.Y. BUS. CORP. LAW § 1318 (McKinney 1963).

337. N.Y. BUS. CORP. LAW § 1320 (McKinney 1963). For the inspection of voting trust records it is also required that the voting trustee have an office or a transfer agent in the state. N.Y. BUS. CORP. LAW § 1316(a) (McKinney 1963).

338. *See, e.g.,* *Toklan Royalty Corp. v. Tiffany*, 193 Okla. 120, 121-22, 141 P.2d 571, 573-74 (1943).

339. CAL. CORP. CODE § 1600(d) (West 1977).

340. *See* RESTATEMENT (SECOND), *supra* note 46, § 304 comment d; Reese & Kaufman, *supra* note 1, at 1124, 1135; *Padovano v. Watzky*, 355 So. 2d 871, 874 (Fla. Dist. Ct. App. 1978).

341. *See* Reese & Kaufman, *supra* note 1, at 1125, 1135 (arguing nevertheless that a stockholder's right to inspect the corporation's books should be governed by local law).

342. In the recent proxy and takeover fight for Louisiana Land & Exploration, a Maryland corporation, the insurgents finally obtained the shareholder list under New York law. "If you

A constitutional attack on California's inspection provisions was recently rejected in *Valtz v. Penta Investment Corp.*³⁴³ The court easily dismissed the full faith and credit and due process challenges, mainly on the *Allstate* ground that the location of the principal executive office and of the books and records in California are "significant contacts" that subject the corporation to the California inspection policy. The court reasoned that inspection of shareholder lists does not require a uniform standard.³⁴⁴ An equal protection argument was rejected because the legislation treats domestic and foreign corporations equally and all foreign corporations with significant contacts are covered by the statute.³⁴⁵ The court also sought to avoid the impact of *MITE* by finding no connection whatsoever between the inspection and "the corporation's ability to do business in more than one state."³⁴⁶ Because there was no burden on interstate commerce, the court decided that it was not necessary to examine the legitimacy of the asserted local interest.³⁴⁷ Even if the imposition of California law were to cause foreign corporations to locate their principal executive offices outside California, "transactions" in interstate commerce would not be affected. In any event, applying local law constitutes a valid condition of doing business in California and does not operate extraterritorially.³⁴⁸

There is little question that the *Valtz* court's narrow perception of the commerce clause as invalidating only direct burdens on the movement of trade across state lines is erroneous. In *MITE* itself the statute that was declared unconstitutional had nothing to do with trade or establishment; it concerned solely the making of tender offers for corporate stock. There is also little merit to the proposition that a corporation having its principal offices or holding board meetings in California thereby automatically submits its shareholder ledger to inspection under local

asked 10 lawyers about it, none would know that New York has that provision,' Bialkin [of New York's Willkie, Farr & Gallagher] said. Kramer [of New York's Skadden, Arps] conceded, 'It's certainly not a well-known provision.'" Masters, *Interest, Doubts Sparked by Season's Proxy Trends*, *Legal Times*, May 23, 1983, at 9, cols. 2-3. These statements are rather puzzling in light of such well-known inspection cases as *Studebaker Corp. v. Gittlin*, 360 F.2d 692, 697-98 (2d Cir. 1966) (affirming order enjoining authorization to inspect shareholding lists); *Gittlin v. Studebaker Corp.*, 25 A.D. 2d 822, 269 N.Y.S.2d 143 (1966) (denying access to shareholders lists); *Crane Co. v. Anaconda Co.*, 39 N.Y.2d 14, 346 N.E.2d 507, 382 N.Y.S.2d 707 (1976) (inspection of shareholder list is allowed unless corporation can show an improper purpose); *Crane Co. v. Westinghouse Air Brake Co.*, 56 Misc. 2d 538, 288 N.Y.S.2d 984 (Sup. Ct. 1968) (right to inspect shareholder lists is unconditional absent proof of an improper purpose).

343. 139 Cal. App. 3d 803, 188 Cal. Rptr. 922 (1982).

344. *Id.* at 806-09, 188 Cal. Rptr. at 924-26.

345. *Id.* at 809-10, 188 Cal. Rptr. at 926.

346. *Id.*

347. *Id.* at 808, 188 Cal. Rptr. at 925.

348. *Id.* at 807-08, 188 Cal. Rptr. at 925.

corporate law. As drafted, the law would apply even where all other major corporate contacts are with the state of incorporation where the ledger is also located and most of the shareholders reside. Why, in this instance, should rights of inspection be determinable under California law? The *Valtz* holding is sustainable, if at all, only if it were limited to ledgers in California and if the unpersuasive local "asset" characterization is accepted or if the decision survives the balancing test because of the de minimis effects on interstate commerce.³⁴⁹

The fact that New York continues to enforce limited application of its law to certain internal affairs matters of foreign corporations under its statutory directives should not mislead one to assume that, outside the statute, the *lex incorporationis* is in jeopardy. In fact, the opposite is true. The New York courts' have remained singularly unreceptive to the siren song of the new conflicts methodologies in this field.

*Hausman v. Buckley*³⁵⁰ remains the cornerstone of the *lex incorporationis* in New York. Charging directors, officers, and controlling shareholders of Pantepec Oil, a Venezuelan corporation, with breaches of fiduciary duty in the sale of corporate assets and in making an unlawful management contract, a derivative plaintiff sought rescission and damages in New York. The very concept of a derivative action, however, is virtually unknown in Venezuela. As in many civil law countries, an action on behalf of the corporation can be brought only if a majority of the shareholders so decide.³⁵¹ Complainants have recourse only to the meeting of shareholders and even there only a holder of ten percent or more of the stock may put the matter to a vote.³⁵²

349. These criticisms also apply to the New York inspection provisions except that the burden of compliance is lesser in New York because only resident shareholders can exercise inspection and informational rights. But the exclusion of non-residents raises a serious question especially under the privileges and immunities clause because residence is not used as a neutral factor with non-residents relegated to the law of their own jurisdiction. That a state has "no legitimate interest in protecting non-resident shareholders," *MITE*, 457 U.S. at 644, in the context of extraterritorial regulation, does not prevent it from making the benefits of local law equally available to out-of-staters. But see *Martin-Marietta Corp. v. Bendix Corp.*, 690 F.2d 558, 562 (6th Cir. 1982) (no privileges and immunities and equal protection challenges made to the Michigan takeover statute whose application had been judicially limited to the protection solely of resident shareholders). The impact of the privileges and immunities clause on choice-of-law remains uncertain and controversial. For a good, brief discussion and references to the writings of Currie, Schreter, and Sedler, see R. CRAMPTON, D. CURRIE & H. KAY, *supra* note 214, at 501-08. See also Ely, *supra* note 222, at 181 (questioning the premise that a state has a greater interest in protecting its own residents than it has in protecting others). On the general topic of discriminatory treatment of non-residents, see Simson, *Discrimination Against Nonresidents and the Privileges and Immunities Clause of Article IV*, 128 U. PA. L. REV. 379 (1979); Varat, *State "Citizenship" and Interstate Equality*, 48 U. CHI. L. REV. 487 (1981).

350. 299 F.2d 696 (2d Cir.), *cert. denied*, 369 U.S. 885 (1962).

351. *Id.* at 701.

352. *Id.* at 698 n.5.

Applying the conflicts rules of New York, Judge Kaufman first rejected plaintiff's claim that the availability of the derivative action is "procedural" and, therefore, subject to forum law: the conditions on the right to enforce corporate claims go to the substance of the claims; the issue is not just "who" or "how" but "if" the action will be brought.³⁵³ The judge then cited many of the older New York cases, including *Newman v. Baldwin*,³⁵⁴ a demand-on-stockholders case, as well as cases from other jurisdictions and the *First Restatement*³⁵⁵ in support of the proposition that the traditional *lex incorporationis* rule continued to prevail in New York.³⁵⁶ What makes this case particularly important is that the modern methodologies were in fact considered—particularly the theories of "center of gravity" and "grouping of contacts"³⁵⁷ but it was nevertheless concluded that those theories did not, at least as yet, apply to corporate stockholder litigation and that the *lex incorporationis* continues to serve the conflicts values of predictability and ease of application and the single-law desideratum.³⁵⁸

The enactment of the New York Business Corporation Law (NYBCL) in 1963, which continued the applicability of some of its derivative suit provisions to foreign corporations,³⁵⁹ and the triumph of the conflicts revolution in New York³⁶⁰ did not lead to an abandonment of *Hausman* in areas such as business trusts, where the NYBCL did not specifically apply. On the contrary, we find a reaffirmation of the *lex incorporationis* as a presumption that apparently may be overcome only in a compelling case. In *Greenspun v. Lindley*,³⁶¹ the lower court cited *Hausman* and other cases in support of the application of the *lex incorporationis* to the demand requirements, but recognized that in "unusual instances the law of the forum or of another state having more

353. *Id.* at 701.

354. 13 Misc. 2d 897, 179 N.Y.S.2d 19 (Sup. Ct. 1958).

355. 299 F.2d at 703 n.11.

356. *Id.* at 703. The court conceded that New York may recognize an exception for foreign "paper corporations" but this was not the case for *Pantepec*. *Id.* at 703 n.11. Apparently the company did no local business and, therefore, the New York statutory exceptions to the *lex incorporationis* did not apply.

357. See *Kilberg v. Northeast Airlines*, 9 N.Y.2d 34, 172 N.E.2d 526, 211 N.Y.S.2d 133 (1961); *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99, — N.Y.S.2d — (1954).

358. 299 F.2d at 703-04 n.14 (citing *Reese & Kaufman*, *supra* note 1).

359. For a discussion of the New York statutory scheme, see *supra* notes 316-37 and accompanying text.

360. See, e.g., *Babcock v. Jackson*, 12 N.Y.2d 473, 478, 191 N.E.2d 279, 285, 240 N.Y.S.2d 743 (1963).

361. 49 A.D.2d 20, 21-22, 352 N.Y.S.2d 633, 637 (1974) (involving a Massachusetts trust), *aff'd*, 36 N.Y.2d 473, 330 N.E.2d 79, 369 N.Y.S.2d 123 (1975).

significant contacts with the transactions might be applied.”³⁶² The Court of Appeals affirmed, emphasizing (a) the voluntary association of the shareholders under a declaration calling for the application of the state of incorporation law, and (b) the pragmatic and theoretical advantages of determining the rights of the shareholders on a uniform basis regardless of forum and of the states of contacts of the trust.³⁶³ But the court left open the possibility that if the trust had been “present” in New York—doing business, headquarters, meetings, assets, shareholdings—New York law may have been applicable.³⁶⁴

The reluctance of the courts to set aside the traditional practice is exemplified by subsequent cases such as *Rottenberg v. Pfeiffer*,³⁶⁵ in which party autonomy and expectations as well as the uniform treatment of the beneficiaries irrespective of residence were cited to support the lex incorporationis rule, even when significant contacts with New York are present. In *Skolnik v. Rose*,³⁶⁶ decided in 1982, the Court of Appeals further narrowed the potential *Greenspun* exception by holding that the agreement of the beneficiaries is governed by the law of a state which has *some* contacts with the business trust will be respected even where the trust has significant contacts with New York.

In the most recent case in this area, the Supreme Court of Kings County went even so far as to engraft the lex incorporationis upon the New York statutory provisions which by their very own terms do apply to foreign corporations doing business in New York.³⁶⁷ The court held that sections 629 and 1319 of the NYBCL, which call for the application of New York law, including the demand requirement, to foreign corporations are not mandatory but only permissive in the sense that they merely invite conflicts analysis!³⁶⁸ Superimposing the “center of gravity” theory on section 1319, and holding that incorporation is superior to headquartering, the court applied to Penn Central the law of its incorporation state—Pennsylvania—where some business transactions also had taken place, over the law of New York where the corporate headquarters were located and significant business had been transacted.³⁶⁹

362. *Id.* at 22, 352 N.Y.S.2d at 637 (citing RESTATEMENT (SECOND), *supra* note 46, §§ 302, 304, 309).

363. 36 N.Y.2d at 477, 330 N.E.2d at 80-81, 369 N.Y.S.2d at 125-26 (1975).

364. *Id.* at 477, 330 N.E.2d at 80, 369 N.Y.S.2d at 125-26.

365. 59 A.D.2d 756, 756-57, 398 N.Y.S.2d 703, 704 (1977).

366. 55 N.Y.2d 964, 965-66, 434 N.E.2d 251, 252, 449 N.Y.S.2d 182, 183 (1982).

367. *See* *Lewis v. Dicker*, 118 Misc. 2d 28, 30-32, 459 N.Y.S.2d 215, 216-18 (Sup. Ct. 1982) (citing *Greenspun* and *Rottenberg*).

368. *Id.*

369. *Id.* Cf. *Stephenson v. Landegger*, 337 F. Supp. 591, 593 (S.D.N.Y. 1971) (where a foreign corporation doing business in New York has more contacts in New York than in its place of incorporation, New York law applies), *aff'd*, 464 F.2d 133 (2d Cir. 1972).

In the derivative suit area, *Galef v. Alexander*³⁷⁰ also deserves special mention. Citing a string of New York cases to the effect that the law of the state of incorporation governs "internal affairs," including questions as to the relationship between the corporation's shareholders and its directors,³⁷¹ the court went on to take notice of the modern methodologies but concluded that even under a grouping-of-contacts approach there appeared to be no basis in the circumstances of that case for believing that a New York court would have applied any law to the termination powers of directors other than that of Ohio, where the company was incorporated.³⁷² Because the corporation in fact had major Ohio contacts, it is difficult to disagree with this conflict conclusion.

The new conflicts methodologies also surfaced in *Gildenhorn v. Lum's, Inc.*,³⁷³ an insider-trading case in which the court explained that the application of the law of Florida was proper also under the "grouping of contacts" and the "governmental interests" theories. In addition to being the state of incorporation, Florida had other "contacts" such as the corporate headquarters, the residence of the plaintiff, and the place where the inside information had been received and communicated. The only New York contact had been the trading of the stock on the New York Stock Exchange. Thus, Florida was found to have had the paramount interest in "defining and enforcing the fiduciary obligations" owed to the enterprise.³⁷⁴

Other issues where the law of incorporation was applied without elaborate discussion include the fiduciary duties of management and controlling shareholders,³⁷⁵ the sale of control,³⁷⁶ the delegation of management functions,³⁷⁷ dissenters' rights in mergers,³⁷⁸ shareholder meetings,³⁷⁹ and shareholder agreements.³⁸⁰

On the other hand, the Second Circuit deftly avoided the lex in-

370. 615 F.2d 51 (2d Cir. 1980).

371. *Id.* at 58.

372. *Id.* at 58 n.14.

373. 335 F. Supp. 329, 333 (S.D.N.Y. 1971), *aff'd sub. nom.*, *Schein v. Chasen*, 519 F.2d 453 (2d Cir. 1975).

374. *Id.* at 332-33. *See also supra* note 97.

375. *See Lachman v. Bell*, 353 F. Supp. 37, 39-40 (S.D.N.Y. 1972) (Delaware law governs duties of management in disposition of corporate assets even where corporation has its principal place of business and other assets in New York). *See also supra* note 95.

376. *See supra* note 98.

377. *See supra* note 101.

378. *See Montei v. Creole Petroleum Corp.*, 61 A.2d 910, 911, 402 N.Y.S.2d 833, 833 (1978) (Delaware law).

379. *See Fairmont Foods Co. v. Manganello*, 301 F. Supp. 832, 835 (S.D.N.Y. 1969). *See also supra* note 102.

380. *See Zion v. Kurtz*, 50 N.Y.2d 92, 100, 405 N.E.2d 681, 684, 428 N.Y.S.2d 199, 203 (1980) (Delaware law). *See also supra* note 104.

corporationis in *Norlin Corp. v. Rooney, Pace Inc.*,³⁸¹ a major recent case in the takeover field which, on the merits, is heralded as a harbinger of a stricter application of the business judgment rule against management's abusive defenses.³⁸² The first issue in the case was whether shareholders could bring a derivative action to vindicate the corporate rights of Norlin against its management for improper issuance of stock to Andes, a wholly owned subsidiary, and to an employee stock ownership plan. Both companies had been incorporated in Panama. Because, however, Norlin had its principal place of business and executive offices in New York, where the shareholders and directors meetings were held, and no significant operations in Panama, the court had no difficulty in avoiding the *Hausman* rule and in applying New York law to the derivative aspect of the case under sections 626 and 1319.³⁸³

The second and more difficult issue was whether the Norlin stock held by Andes could be voted. Under New York law, the answer was clearly in the negative.³⁸⁴ But under the law of Panama, such stock would lose its voting rights only if the corporation was registered at the National Sales Commission or its shares were sold in the Panamanian markets, which was not the case here.³⁸⁵ This issue not being within the New York statutory provisions, the court first recognized that the law of Panama is relevant but cautioned that it should not be applied automatically and that exceptions are possible in the circumstances outlined in *Greenspun v. Lindley*,³⁸⁶ decided by the New York Court of Appeals in 1975.³⁸⁷ Interestingly, the *Norlin* court did not cite *Zion v. Kurtz*,³⁸⁸ the last and clear pronouncement of the New York Court of Appeals, and a ringing reaffirmation of the primacy of the lex incorporationis as the "generally accepted choice-of-law rule in New York."³⁸⁹ After reviewing the major Norlin contacts with New York, including the listing of its stock on the New York Stock Exchange and the issuance of the stock in question in New York, the court evaded the question whether they would be sufficient to override the law of Panama by stressing that, in the circumstances of the case, Panama had expressed no legitimate and substantial interest in this matter. The court read the limitations on the scope of the

381. 744 F.2d 255 (2d Cir. 1984).

382. See Sommer, *The Norlin Case and Business Judgment Rule*, 17 REV. SEC. REG. 799-803 (1984); Junewicz, *Advanced Planning is Necessary to Battle New Defense Strategies*, Nat'l L.J., Oct. 8, 1984, at 18, col. 2.

383. 744 F.2d at 261.

384. *Id.* at 262 (citing section 612(b)).

385. *Id.* (citing Articles 35 and 37 of Panamanian Cabinet Decree 247 of July 16, 1970).

386. *Id.* at 263.

387. 36 N.Y.2d 473, 330 N.E.2d 79, 369 N.Y.S.2d 123 (1975).

388. 50 N.Y.2d 92, 405 N.E.2d 681, 428 N.Y.S.2d 199 (1980).

389. *Id.* at 100, 405 N.E.2d at 684, 428 N.Y.S.2d at 203.

Panamanian law to mean that there was a gap in the law which could be filled by New York,³⁹⁰ not, as would have been more natural under principles of statutory interpretation, that for other corporations the Panamanian rule was that the stock retained its voting rights.

Finally, when the court reached crucial issues on the merits of the dispute—whether the issuance of the stock in fact did constitute a breach of fiduciary duty and what was the scope of the business judgment rule—it proceeded to apply substantive New York law without any discussion or explanation whatever,³⁹¹ even though it should have been clear that its treatment of the prior two issues was not dispositive of, or even germane to, what law should apply to the merits.

How far will New York go in enforcing its fiduciary principles in takeover battles is a matter of considerable practical importance, but *Norlin* is too ambiguous to furnish a reliable guide. Given the unwillingness of the court even to confront the issue of deviating from the internal affairs rule, a prudent reading of the case should respect the *lex incorporationis* but leave open the possibility of applying New York law when the corporation is centered in New York in most major respects, in line with the philosophy of the other New York cases.

D. *The Lex Incorporationis and the Metamorphosis of State Takeover Legislation.*

1. *The Commerce Clause Problem.* The typical state takeover statute that ran into early trouble in the lower courts and finally fared so badly in *MITE* is rapidly disappearing. But the proponents of the idea are not giving up. A major push has been under way to internalize takeover controls so as to bring them within the authority of the law governing the target corporation. Exempting foreign corporations, however, is not enough to overcome the commerce clause problem. To come within the realm of internal affairs, the takeover model must change in substance, not just in form.³⁹²

a. *Ohio regulation of "control share acquisitions."* Ohio, an aggressive antitakeover state, rushed to respond to the *MITE* challenge by adopting a new type of internalized control. The acquisition of shares,

390. 744 F.2d at 264.

391. *Id.* at 264-67.

392. Even if the commerce clause problem were to be overcome, however, there is little question that state takeover controls in whatever form do interfere with interstate tender offers and, therefore, may be preempted by the Williams Act, 90 Pub. L. No. 439, 82 Stat. 456 (codified at 15 U.S.C. § 78 (1982)) and thus would fall on supremacy grounds. The *MITE* majority did not address the preemption issue in view of its disposition of the case under the commerce clause. The potential impact of the proposed federal tender offer controls on the new state takeover statutes is too tangential a subject to be considered in this article.

by tender offer or otherwise, that would make the acquirer a holder of twenty percent or more of the voting stock of a corporation are now subject to Ohio corporate law as "control share acquisitions."³⁹³ In terms of coverage, however, this legislation makes a major retrenchment from the original controls that extended to many foreign corporations. Only Ohio-incorporated, publicly-held targets with at least one additional substantial local connection—principal place of business, principal executive offices, or substantial assets within the state—are included regardless of local shareholdings.³⁹⁴

The regulation treats the "control share acquisitions" similarly to mergers and consolidations; they must be approved by a majority of both the entire voting power and the disinterested voting power of the corporation.³⁹⁵ "Control bids" made to Ohio residents in Ohio—offers to purchase shares that will increase the offeror's holdings to more than ten percent—and oppositions to such bids are also made subject to the Ohio antifraud rules irrespective of any connection between the corporation and/or its shareholders and Ohio.³⁹⁶

Whether this regulation of "control share acquisitions" will pass commerce-clause muster under the *lex incorporationis* will depend on whether the internal affairs label is credible. The Ohio General Assembly articulated an express finding to that effect, emphasizing also the minimal impact on interstate commerce.³⁹⁷ But, of course, this self-serving statement should not be dispositive. The arguments for and against such characterization of the old tender offer controls have been discussed

393. OHIO REV. CODE ANN. § 1701.01(r)(1) (Page Supp. 1983).

394. OHIO REV. CODE ANN. § 1701.01(y), (z) (Page Supp. 1983). For a discussion of the particulars of the statute, see Bartell, *supra* note 172, at 809; Kreider, *Fortress Without Foundation? Ohio Takeover Act II*, 52 U. CIN. L. REV. 108, 108-23 (1983); Profusek & Gompf, *supra* note 168, at 36-41; Warren, *Developments in State Takeover Regulation: MITE and its Aftermath*, 40 BUS. LAW. 671, 694-96 (1985).

Mindful of the *MITE* recognition of the legitimacy of the state's protective interest in local shareholders, the Ohio Assembly explained that it did not include an express local shareholding requirement "because of the difficulty of ascertainment by potential acquirers and others of the residence of shareholders" and proceeded to find that "corporations containing the jurisdictional nexus . . . may be deemed to have a substantial and significant shareholder base in the state." 1983 Ohio Legis. Bull. Amended Substitute HB No. 822, § 3 (Anderson). This is ingenious but unconvincing. The jurisdictional criteria used are not shareholder-oriented. Certainly the acquirers would be delighted to be exempted from regulation if they could disprove local shareholdings. Furthermore, the addresses of the record holders may be used to corroborate or even to establish a reasonable residence connection as under CAL. CORP. CODE § 2115 (West 1977). If the internal affairs characterization of the regulation is upheld, the shareholder connection would be merely reinforcing; if it is rejected, however, only the presence of an overwhelming number of shareholders and shares in the state could perhaps suffice by itself to outweigh the out-of-state burdens.

395. OHIO REV. CODE ANN. § 1701.831 (Page Supp. 1983).

396. OHIO REV. CODE ANN. §§ 1701.01, 1707.041-.042 (Page Supp. 1983).

397. See 1983 Ohio Legis. Bull. Amended Substitute HB No. 822 §§ 2, 3 (Anderson).

earlier.³⁹⁸ At least two important new features reinforce the internal affairs argument. First, the new system is voluntary in that it applies only if the charter or by-laws of the corporation do not exclude it. Second, the only requirement is shareholder approval of the acquisition following the filing of a disclosure statement with the corporation. The offer is not subject to the prior obstructionist control of a state agency and there is no differentiation between friendly and hostile offers.³⁹⁹ An attractive offer for a substantial percentage of the stock is thus likely to receive the requisite votes and tenders, although some delay may occur.

It must be conceded that while the new controls go beyond the regulation of the internal workings of the corporation and extend to private transactions among stockholders, they nevertheless create rights and obligations in shareholders qua shareholders. As such, these controls resemble restrictions on the transferability of shares and on transactions in corporate control which normally fall within the internal affairs domain.⁴⁰⁰ In the statute itself the takeover controls are placed among the other restrictions on the transfer of shares and it is expressly provided that the by-laws may impose additional director or shareholder consent requirements.⁴⁰¹ It may be that acquisition controls, unlike typical transfer restrictions, are aimed at preventing someone else from becoming a shareholder rather than at merely preserving the original composition of shareholders—the “*intuitus personae*.” But the same is true of such transfer restrictions as consent requirements or prohibitions against transfers to designated persons or classes of persons, which are generally valid except when they serve no legitimate purpose.⁴⁰² The imposition of fiduciary obligations on sales of control stock is traditionally also classified as an internal affairs matter. In support of the internal affairs character of these controls, Ohio can also point to certain provisions of its law

398. See *supra* notes 173-74.

399. See Kreider, *supra* note 394, at 120; Profusek & Gompf, *supra* note 168, at 40.

400. But see Kreider, *supra* note 395, at 121 (noting that the Second Ohio takeover act regulates individual transactions in contrast to internal corporate statutes which apply to corporate action); Profusek & Gompf, *supra* note 168, at 40-41. Cf. *Telvest v. Bradshaw*, 697 F.2d 576, 579-82 (4th Cir. 1983) (even though statute applies only to Virginia corporations, it has extraterritorial effects because it covers transactions among nonresidents).

401. OHIO REV. CODE ANN. § 1701.11(B)(8) (Page Supp. 1983). At least one Ohio corporation is moving ahead to make such acquisitions subject to a two-thirds rather than a majority approval. See *GF Business Holders are Asked to Approve New Name, Structure*, Wall St. J., May 3, 1983, at 16, col. 2.

402. See, e.g., DEL. CODE ANN. tit. 8, § 202(e)(3)&(4) (1983); *St. Louis Union Trust Co. v. Merrill, Lynch, Pierce, Fennell & Smith, Inc.*, 562 F.2d 1040, 1046 (8th Cir. 1977); *Grynburg v. Burke*, 378 A.2d 139, 143 (Del. Ch. 1977). On the validity under Delaware law of restrictions against transfer of shares of stock to aliens including prohibitions against acquisitions by aliens of more than stated percentages, see Finkelstein, *Stock Transfer Restrictions Upon Alien Ownership Under Section 202 of the Delaware General Corporation Law*, 38 BUS. LAW. 573, 573-92 (1983).

that subject to director and shareholder approval certain "majority share acquisitions" by a domestic corporation or a domestic or foreign subsidiary in exchange for more than one-sixth of the voting stock of a domestic corporation.⁴⁰³ These kinds of provisions have been assumed to fall within the power of the state to regulate combinations of its corporations and the issuance of stock to effectuate them. To be sure, applying local law to "control share acquisitions" in domestic corporations may well operate extraterritorially but so do most internal affairs rules.⁴⁰⁴ This is the natural consequence of referring such matters to the *lex incorporationis*. In conclusion, the Ohio controls have a better chance than ever to survive a commerce challenge.⁴⁰⁵

b. *The Maryland controls over second-tier transactions.* Maryland has chosen a different escape route but again through the "internal affairs" channel.⁴⁰⁶ Rather than regulating the original acquisition, Mary-

403. OHIO REV. CODE ANN. §§ 1701.01(R), 1701.83(A) (Page 1978 & Supp. 1983).

404.

These provisions [supermajority votes, fair pricing] of the second-generation statutes may be said to constitute burdens because of their direct impact on a particular type of transaction. But is their extraterritorial effect really any greater than that of the general corporation statute's voting, proxy, merger, appraisal or "going private" provisions on the nonresident shareholders of public corporations?

Sargent, *supra* note 53, at 28 n.81. Cf. *Ashley v. Ryan*, 153 U.S. 436, 446 (1894) (although a state may not lay charges on interstate commerce and may not prevent foreign corporations from engaging in interstate commerce within its borders, it has the power to determine "upon what conditions its laws as to consolidation of corporations may be availed of"); 15 FLETCHER CYCLOPEDIA OF CORPORATIONS § 1162 (1983).

It should also be pointed out that the Ohio controls, unlike those of Michigan held unconstitutional in *Martin Marietta*, see *supra* note 181, because of their effects on out-of-state transactions, do not enable Ohio shareholders to deny other shareholders the benefit of the tender offer. The fate of an acquisition rests with all shareholders equally. See Profusek & Goinpf, *supra* note 168, at 25-26.

405. Recent comment on the new Ohio system has been generally favorable but guarded. Professor Shipman, an early and persistent supporter of the Ohio anti-takeover stance, stresses the internal affairs characterization and the shortness of the delay. Only the state of incorporation would be exercising such authority, so there is no risk of conflict with the laws of other states. See *House Panel Finds Little Agreement on Federal Tender Offer Law Reform*, 16 SEC. REG. & L. REP. (BNA) No. 23, at 915, 916 (May 25, 1984). See also Note, *Corporate Battles for Control*, *supra* note 163, at 1474. Others, while recognizing the legitimacy of the *lex incorporationis*, are "queasy" because of the uncertainty generated by the slow approval requirements and because of the effects on out-of-state transactions. See *RICO's Reported Demise, Tender Offers, ULOE Adoption Considered at ABA Meeting*, 16 SEC. REG. & L. REP. (BNA) No. 33, at 1392, 1393-94 (Aug. 17, 1984) [hereinafter cited as *RICO's Reported Demise*]; Easton, *With Caution States Refashion Takeover Barriers*, *Legal Times*, April 23, 1984, at 2, col. 1. Local incorporation coupled with a significant local connection, as is done under the Ohio approach, would seem to satisfy Sargent's requirement that the corporation have sufficient local identity to outweigh the incidental burden on interstate commerce. See Sargent, *supra* note 53, at 22-24, 30-34.

406. House Bill No. 1020 as originally passed by the Maryland House was quite controversial and was vetoed by the Governor after a number of major Maryland corporations threatened to move out. Following certain amendments, the bill passed again and the governor signed it on June 22, 1983. Act of June 21, 1983, 1983 Md. Laws 2464-66. On the history of this bill as well as on the increasing use, by charter amendment, of anti-second-tier provisions, see *Maryland Bill on Takeovers*

land, like Ohio, focuses on the second tier—the extension of control by the successful tender-offeror. The initial acquisition of shares through a tender offer or otherwise in one or more transactions is unaffected. But a “business combination” between a corporation and any ten percent shareholder requires not only the recommendation of the board, but also eighty percent approval by the total outstanding stock and two-thirds approval by the outstanding stock held by those other than the ten-percent shareholder, voting together “as a single voting group.”⁴⁰⁷ Even with these approvals, the rights of dissenting shareholders are strengthened.⁴⁰⁸ An exemption is provided where the remaining shareholders are bought out at the highest of certain alternative prices,⁴⁰⁹ provided that no action adverse to minority shareholders has been taken at the corporate level and that the ten percent shareholder has not increased his holdings since acquiring that status.⁴¹⁰

These rules apply to all corporations organized under the law of Maryland unless their charter is amended by a vote of eighty percent of the shareholders, including two-thirds of the disinterested shareholders, to disclaim coverage.⁴¹¹ Thus, the only required connection is the naked fact of incorporation in Maryland. There seems little question about the internal affairs nature of these “business combinations,” and challenges to the application of Maryland law under the commerce clause will be difficult.⁴¹²

c. *The Pennsylvania extension.* What is probably the strictest system of antitakeover regulation was recently enacted in Pennsylvania. In essence, Pennsylvania engrafts a dissenter's right not on the second-tier but on the very acquisition of “control,” that is, at least thirty percent of

Spurs a Fight, Wall St. J., May 26, 1983, at 33, col. 3. For a comprehensive description of the statute, see Scriggins & Clarke, *Takeovers and the 1983 Maryland Fair Price Legislation*, 43 MD. L. REV. 266 (1984).

407. MD. CORPS. & ASS'NS CODE ANN. § 3-602 (Supp. 1984). “Business combination” is redefined to include mergers, consolidations, share exchanges, certain sales of more than 10% of the assets, issuance of more than five percent of the stock, liquidation, dissolution, and reclassifications or recapitalizations of securities involving the 10% shareholder.

408. See MD. CORPS. & ASS'NS CODE ANN. §§ 202(a)(5), (b)(3) & (c) (Supp. 1984).

409. MD. CORPS. & ASS'NS CODE ANN. § 3-601(E) (Supp. 1984).

410. MD. CORPS. & ASS'NS CODE ANN. § 3-603(E) (Supp. 1983). The alternative prices include the price paid in the first tier of a tender offer.

411. MD. CORPS. & ASS'NS CODE ANN. § 3-603(E)(1)(iii) (Supp. 1984).

412. It is the view of many commentators that Maryland's is the most likely of the second-level antitakeover statutes to survive a constitutional challenge. Sargent, *supra* note 53, at 27; Warren, *supra* note 394, at 698; Easton, *supra* note 405, at 2, col. 1; *RICO's Reported Demise*, *supra* note 405, at 1394. The least defensible aspect of the Maryland statute is the inclusion of the sale of more than 10% of the assets, wherever situated, among the covered transactions. It has been reported that Michigan S. Bill No. 541, recently adopted, incorporates a similar plan. Sargent, *supra*, note 53, at 10 n.24.

the total voting power of a corporation.⁴¹³ "Dissenting" shareholders may make a demand on the acquirer for payment of the "fair value" of their shares, including any control premium component, under an appraisal-type proceeding.⁴¹⁴ The likely practical effect of this system would be to compel tender offerors for more than thirty percent to extend their offers to one-hundred percent of the outstanding shares, in a manner similar to the British system.⁴¹⁵ As if this were not enough, second-tier transactions such as mergers, consolidations, and sales of substantially all the assets, between a "controlling" shareholder and the corporation or a subsidiary are also required to be approved by a majority vote of the disinterested shareholders.⁴¹⁶ The same vote is needed to validate corporate dissolution or liquidation if the "controlling" shareholder receives preferential treatment.⁴¹⁷ Finally, in an obvious "local interest" vein, the board of directors is now specifically empowered, in exercising its business judgment, to consider the effect of its actions upon the employees, suppliers, and customers of the corporation and upon the communities where offices or other establishments of the corporation are located.⁴¹⁸

The language and the location within the statute of these provisions demonstrates that an attempt is being made to treat "control" acquisi-

413. Act of Dec. 23, 1983, No. 92, § 910, 1983 Pa. Legis. Serv. 775, 777-78 (Purdon). For a full commentary on the Act, see Newlin & Gilmer, *The Pennsylvania Shareholder Protection Act: A New State Approach to Deflecting Corporate Takeover Bids*, 40 BUS. LAW 111 (1984). A similar system is under consideration in Missouri (S. Bill 409, in author's possession) and in Hawaii, see 16 SEC. REG. & L. REP. (BNA) No. 11, at 514 (Mar. 16, 1984). A number of Pennsylvania corporations, including Gulf Oil and Scott Paper, were reportedly the prime movers behind the legislation. See *Bill That Could Deter Hostile Takeovers Nearing Pennsylvania Senate Vote*, Wall St. J., Dec. 6, 1982, at 8, cols. 1-3. Corporations that have no class of voting shares registered under the Securities Exchange Act of 1934 are exempted. Act of Dec. 23, 1983, No. 92, § 910(g). In addition, the articles of incorporation may explicitly provide that section 910 shall not be applicable. Act of Dec. 23, 1983, No. 92, § 910(A). Sun Company reportedly opted out under subsection (A) in order to leave open the possibility of a friendly takeover. See *Sun Co. Remains Speculative Merger Target as Price Rises, Volume Gains Despite Denials*, Wall St. J., Mar. 22, 1984, at 61, cols. 3-4. But Sun can not escape the anti-second-tier provisions of the law. See *id.* Similar action was also taken by the Philadelphia Electric Company. See LV CORP. REP. BULL. (PH) No. 8, at 6 (Apr. 10, 1984).

414. Act of Dec. 23, 1983, No. 92, § 910(E).

415. See Prentice, *Take-Over Bids—The City Code on Take-Overs and Mergers*, 18 MCGILL L.J. 385 (1972).

416. Act of Dec. 23, 1983, No. 92, § 409.1(c)(1). This section does not apply to transactions approved by a majority vote of the disinterested directors and to transactions where the consideration received by the shareholders is not less than the highest amount paid by the "controlling" shareholder for any of his shares. *Id.* § 409.1(c)(2).

417. *Id.* § 409.1(c)(1).

418. *Id.* § 408(b). It would appear that these provisions apply to all Pennsylvania-incorporated companies irrespective of any other contact to the state of the corporation, the directors, and the shareholders or the tender offeror, and of any connection between the "control" acquisition itself and the state. *Id.* §§ 2(6), 3(1).

tions as involving fundamental corporate changes that should be governed by the *lex incorporationis*. But, unlike Ohio and Maryland, Pennsylvania goes beyond subjecting the acquisitions to special approvals or even imposing particular terms on subsequent consolidations; it also mandates the purchase of the shares of the dissenters *whether or not* the acquirer proceeds to the second-tier. The treatment of a mere acquisition of control as tantamount to a fundamental change on the order of a merger that transforms the very identity and essence of the corporation may be extreme, but it does not necessarily destroy the internal affairs character of the regulation. But carrying this treatment to its ultimate conclusion by triggering dissenters' rights is a more serious matter. If substance is to prevail over form, it should be recognized that the principal effect of this system is to require tender offerors to buy all of the stock of the target. Thus, it operates very much like a regulation of securities transactions, and one could argue that the restrictions against extraterritoriality should apply to this last feature of the system.⁴¹⁹

d. *The Minnesota-Wisconsin dare: reaching takeovers of foreign corporations under the umbrella of blue-sky regulation.* The Minnesota Take-Overs Act of 1984 institutes a two-fold program of controls.⁴²⁰ Not only does it cover "control share acquisitions" of domestic corporations in the Ohio style,⁴²¹ but it also requires certain tender offerors to file a registration statement containing a variety of disclosures, including information on the economic effects of planned changes in the target's business.⁴²² In addition, substantive fairness requirements are imposed,⁴²³ and a second-tier transaction within two years triggers an obligation to offer to Minnesota residents substantially equivalent terms in a manner resembling the Maryland system.⁴²⁴

419. Newlin and Gilmer seek to distinguish the Pennsylvania approach from that condemned in *Edgar* by emphasizing the absence of disclosures and regulatory controls and the lack of delay and by pointing out its internal affairs nature and its application only to locally-incorporated targets. Thus, they argue, the Act has no extraterritorial effect. See Newlin & Gilmer, *supra* note 413, at 118-22. See also, *RICO's Reported Demise*, *supra* note 405, at 1394 (the Pennsylvania approach falls between Ohio's maximum and Maryland's minimum).

420. MINN. STAT. ANN. §§ 80B; 302A (West Supp. 1984). It has been reported that at least one corporation, Minstar, Inc., is planning to leave Minnesota and reincorporate in Delaware to escape these controls. See *Ministar Plans to Ask Holders to Approve Reincorporation Plan*, Wall St. J., Mar. 15, 1985, at 40, col.2. The fact that Irwin Jacobs, a notorious raider, heads Ministar perhaps explains this antitakeover philosophy.

421. MINN. STAT. ANN. § 302A.671 (West Supp. 1984). A bill was recently introduced in the state Senate — S. 729 — that would repeal this section. See 17 SEC. REG. & L. REP. (BNA) No. 13, at 556 (Mar. 29, 1985).

422. MINN. STAT. ANN. § 80B.03(6) (West Supp. 1984).

423. MINN. STAT. ANN. § 80B.06 (West Supp. 1984).

424. MINN. STAT. ANN. § 80B.06(7) (West Supp. 1984).

Where it goes beyond "control share acquisitions," the regulation proceeds on a blue-sky theory—it applies only to those tender offers which are made to resident shareholders.⁴²⁵ Thus, an offeror who totally by-passes Minnesota is unaffected by this legislation. Furthermore, only the shares of certain publicly-owned targets are covered. But instead of referring to the state of incorporation to identify the targets, the statute focuses solely on twenty percent ownership of the stock by Minnesota residents plus corporate ownership of "substantial assets" in the state.⁴²⁶ Thus, foreign corporations are clearly included. But the special civil remedies for violating the statute—disenfranchisement for one year, non-transferability of shares and a corporate option to redeem the shares at book or cost—are available only to, or for the benefit of, Minnesota residents.⁴²⁷

There have been at least two cases which addressed the constitutionality of certain of these provisions. In *Edudata v. Scientific Computers*,⁴²⁸ the tender offeror was able to obtain a temporary restraining order against enforcement pending a hearing on the merits, but the case was settled shortly thereafter and the issue never came to a head.⁴²⁹ But in *Cardiff Acquisitions v. Hatch*,⁴³⁰ the Eighth Circuit Court of Appeals affirmed a lower court decision upholding the disclosure provisions of the statute against a commerce clause challenge on two grounds. First, the provisions do not significantly burden interstate commerce; there exist no precommencement filing period, no delay, and no fairness tests. Second, they are convincingly limited to the protection of only Minnesota residents of Minnesota-connected corporations.⁴³¹

Wisconsin went even further than Minnesota by combining the Ohio and Maryland approaches for domestic, locally-connected corporations⁴³² to a blue-sky registration, fair pricing, antifraud scheme for takeovers not only of domestic, but also of those foreign corporations which are connected with Wisconsin by having there (a) their principal place of

425. MINN. STAT. ANN. § 80B.06(8) (West Supp. 1984).

426. MINN. STAT. ANN. § 80B.01(9) (West Supp. 1984). In *Cardiff Acquisitions v. Hatch*, 751 F.2d 906, 911 n.4 (8th Cir. 1984), the "substantial assets" language had been interpreted by the State Commissioner to catch only corporations having their primary place of business in Minnesota. The particular target in that case had most of its manufacturing facilities, all of its research and testing centers, almost three-fourth of its employees, and more than 20% of its shareholders in Minnesota.

427. MINN. STAT. ANN. §§ 80B.06(n), 80B.10(4) (West Supp. 1984).

428. See *Scientific Computers Will Pay \$6.4 Million to End Edudata Offer*, Wall St. J., Oct. 29, 1984, at 41, col.4 (unpublished order).

429. See *id.*

430. 751 F.2d 906 (8th Cir. 1984).

431. *Id.* at 909-12. The court did not pass on the constitutionality of the "fair pricing" second-tier requirements on the ground that they had not been invoked by the state. *Id.* at 914.

432. WIS. STAT. §§ 180.69, 180.725 (West Supp. 1984).

business, (b) substantial assets, (c) securities registered or exempt under Wisconsin or federal law, and (d) 100 resident shareholders or five percent of their stock owned by residents.⁴³³ Certain of these provisions apply only to those corporations whose securities are either (a) not registered, or (b) held fifty-one percent by residents, or (c) held thirty-three percent by residents where the corporation's principal place of business is located in Wisconsin or its operations have a "substantial economic effect" in the state.⁴³⁴ The blue-sky rationale is reinforced by the fact that these controls apply only to tender offers made in Wisconsin.⁴³⁵

Whether the Minnesota and Wisconsin controls as they apply to foreign corporations will eventually survive the commerce clause challenges is difficult to predict. Shorn of the full "internal affairs" crutch, they will stand or fall depending on whether the burden that they impose on interstate commerce is deemed to be outweighed in each particular instance by the state interests in the protection of resident shareholders and in the control over offers made within the state. *Martin Marietta* and the related cases⁴³⁶ stressed the burden of the interstate effects even where the regulation is limited to intraterritorial persons and events. By contrast, *Cardiff* tipped the balance in the opposite direction by focusing on the insignificance of the particular interstate effects and on the strength of the state interests and powers in the specific context of that case. In addition, *Cardiff* appeared to bring in an "internal affairs" consideration through its references to the Minnesota connections of the target. The many requirements of real corporate contacts with the state in the Minnesota and Wisconsin systems can be used to construct "pseudo-foreign" corporation basis for the legislative intervention which should be given credence to the extent that such requirements catch only those corporations that are in all material respects genuinely local.⁴³⁷

Even if these cases were to be reconciled by distinguishing them on their facts or on the differences in the legislative schemes, there is little question that they exemplify differing philosophies on the importance of state regulation of multistate takeovers. Which view ultimately prevails

433. WIS. STAT. § 552.01(6) (West Supp. 1984).

434. WIS. STAT. § 552.05(7) (West Supp. 1984).

435. WIS. STAT. § 552.05(1) (West Supp. 1984).

436. See *supra* notes 181 & 183. Cf. BLUE SKY LAW REP. (CCH) ¶ 71,845 (Apr. 2, 1983) (opinion of the Nebraska Attorney General that the Nebraska Takeover Act of 1983, which mandates certain disclosures in connection with all takeovers for domestic or foreign targets which have 35 or more resident shareholders, is unconstitutional under *Edgar* since it applies to "transactions not involving Nebraska residents or corporations, and taking place wholly outside Nebraska"). The Attorney General did not consider whether the limited remedies provided for violations of the statute, mainly injunctions and liabilities in connection with offers in Nebraska, could have saved some or all of the statute on a blue-sky analogy.

437. See *supra* notes 253-67.

will depend on the amplitude with which the Supreme Court interprets the *MITE* language on the role left to the states and on the assumed validity of blue-sky type state power.⁴³⁸

2. *The Preemption Issue.* In *Edgar*, no view commanded a majority on whether the Illinois statute was also inconsistent with the Williams Act and, therefore, preempted under the supremacy clause.⁴³⁹ Because the metamorphosis of state takeover statutes is likely to bring many of their features within the internal affairs realm and thus overcome the commerce clause challenge, the preemption issue will probably surface again. Excessive meddling in interstate tender offers is best dealt with through a preemption analysis rather than by second-guessing the internal affairs character of the new controls under the commerce clause. Indeed, an exclusive federal regulation of tender offers for the stock of interstate corporations would override not only state takeover controls but also inconsistent state corporate law, thus invalidating numerous defensive measures now used or abused under permissive state law.⁴⁴⁰ A preemption approach could leave room for state regulation of local offers as, for example, under section 1904(c) of the American Law Institute's proposed Federal Securities Code of 1978.⁴⁴¹ This section imposes a double cumulative requirement of localisin: To escape federal preemp-

438. See *Edgar*, 457 U.S. at 646 (Powell, J., concurring).

439. *Edgar*, 457 U.S. at 634-40.

440. Management action or proposals to institute antitakeover defenses permissible under state law have reached the level of an epidemic. Most of these efforts prove successful. See *supra* note 6. See also Lautzenhiser, *State and Federal Regulation of Shark Repellant Provisions: How Much is Needed?*, 11 N. KY. L. REV. 481 (1984); *Anti-Takeover Measures in 1984 Seen Matching or Exceeding Last Year's Pace*, Wall St. J., Mar. 30, 1984, at 10, col. 2. The management of Dow Jones itself is proposing the declaration of a 50% dividend in a new class of stock transferable only to major shareholders. The effect of this would be to delist all of its stock from the NYSE. Minority shareholders have lost the first round in a court challenge against the legality of the dividend. See *Dow Jones Holders Lose Court Bid to Block New Class of Stock*, Wall St. J., Feb. 27, 1984, at 12, col. 2. Sometimes the opponents of antitakeover defenses combine litigation with a proxy fight. See *Nortek Lawsuit Seeks to Halt Woodhead's AntiTakeover Moves*, Wall St.J., Feb. 7, 1985, at 4, cols. 5-6; *An Urgent Message to All Stockholders of Daniel Woodhead, Inc.*, Wall St.J., Feb. 1, 1985, at 28, cols. 1-2. A new and promising development is the increasing opposition of institutional investors, including pension funds and employee ESOPS, to management's self-entrenching antitakeover policies. See *Institutional Investors Form Council to Address Corporate Takeover Issues*, 17 SEC. REG. & L. REP. (BNA) No 4, at 159-60 (Jan. 25, 1985). For a fascinating example of a situation where, apparently under shareholder pressure, management itself embarked on a campaign to repeal structural shark repellents, see *Fortune Financial Group Inc.* proxy ad, Wall St.J., Feb. 6, 1985, at 37, cols. 5-6. On the legality of some antitakeover defenses under traditional state law, see Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L.J. 291, 307-09 (1984); see also Lautzenhiser, *supra*; Comment, *Testing the Flight of the Golden Parachute: Judicial Smooth Sailing or Turbulence Ahead?*, 11 N. KY. L. REV. 519 (1984).

441. FED. SEC. CODE § 1904(c) (Proposed Draft 1978).

tion, not only is a major local connection—that is, the principal place of business—of the target corporation itself required but also at least fifty percent of the shareholdings and shareholders must be local. By contrast, Recommendation 9 of the SEC Advisory Committee on Tender Offers promotes a “local” definition based on state of incorporation, fifty percent of shareholdings within such state, and certain maximum size and stock-trading requirements.⁴⁴² The Advisory Committee’s approach favoring the *lex incorporationis* rather than the law of the state of principal business in the non-preempted area is more consistent with the “internal affairs” nature of the subject matter and with the state interest in the shareholders themselves.

VII. THE INTERNATIONAL DIMENSIONS OF THE LEX INCORPORATIONIS AND THE FEDERAL SECURITIES LEGISLATION

In choosing the law applicable to internal corporate affairs the states have drawn no distinctions between sister-state and foreign country corporations.⁴⁴³ In addition, the commerce clause is not limited to interstate dealings but extends to foreign trade and transactions as well. Thus, the same criteria are used in both the interstate and the international contexts.

Another matter which deserves attention here is the international applicability of federal law that affects internal corporate affairs. In particular, the Securities Exchange Act of 1934 (the “Act”)⁴⁴⁴ clearly has had some impact, and some conflicts consideration is warranted.⁴⁴⁵ Although the main thrust of the Act is to regulate trading in securities, a subject matter unrelated to internal affairs, there are at least four areas

442. SEC Advisory Committee on Tender Offers—*Report of Recommendations*, FED. SEC. L. REP. (CCH) No. 1028, at 17 n.17 (July 15, 1983); see also Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 255 (1983) (approving reference to the law of the state of incorporation for antitakeover defenses).

443. See, e.g., *Hausman v. Buckley*, 299 F.2d 696, 702-03 (2d Cir.), cert. denied, 369 U.S. 885 (1967); cf. *First Nat'l City Bank v. Banco Para El Comercio Exterior De Cuba*, 462 U.S. 611, 615 (1983) (referring to the conflicts rule of *lex incorporationis* in the context of a Cuban corporation).

444. 15 U.S.C. §§ 78a-78kk (1982).

445. See Rosenfeld, *Extraterritorial Application of U.S. Laws: A Conflict-of-Laws Approach*, 28 STAN. L. REV. 1005, 1011-14 (1976) (discussing the international applicability of the Securities Exchange Act of 1934); Steinberg, *The Securities and Exchange Commission's Administrative, Enforcement, and Legislative Programs and Policies—Their Influence on Corporate Internal Affairs*, 58 NOTRE DAME LAW. 173, 179-226 (1982) (discussing the SEC's influence on internal corporate affairs); see also Thomas, *Extraterritoriality in an Era of Internationalization of the Securities Markets: The Need to Revisit Domestic Policies*, 35 RUT. L. REV. 453, 465-66 (1983) (discussing the international applicability of the securities laws); Thomas, *Extraterritorial Application of the U.S. Securities Laws: The Need for a Balanced Policy*, 7 J. CORP. L. 189 (1982).

where the Act intersects with them: proxy regulation,⁴⁴⁶ periodic reporting requirements of management to shareholders,⁴⁴⁷ short-swing profit disgorgement rules,⁴⁴⁸ and securities fraud perpetrated on the corporation by its fiduciaries.⁴⁴⁹ Although the federal law purports to be neither comprehensive nor preemptive of state law, its complementary character does not make it any less relevant to internal affairs, thus raising questions about its applicability to foreign corporations.⁴⁵⁰

A. *The Explicit Controls Under the Securities Exchange Act of 1934 and the Securities and Exchange Commission Rules.*

The voting rights of shareholders are at the core of corporate governance. The rules controlling the solicitation and use of proxy statements and the related informational obligations for shareholder meetings significantly affect the exercise of such voting rights. Professor Eisenberg has cogently argued that, at least in the public corporation, voting by proxy has replaced the shareholders' meeting as the principal vehicle for

446. 15 U.S.C. § 78n(a) (1982).

447. 15 U.S.C. §§ 78l, 78m (1982).

448. 15 U.S.C. § 78p(b) (1982).

449. 15 U.S.C. § 78j(b) (1982).

450.

The Act and the Proposed Rules [later adopted] taken in combination raise serious questions of international law. In essence, the question is whether . . . the United States has jurisdiction to regulate the internal affairs of foreign corporations which have no contacts with the United States other than the requisite number of shareholders [300 residents in United States].

[If foreign issuers] "voluntarily" accept the jurisdiction of the Commission by listing or publicly selling their securities in the United States, there is no problem [under international law] at least to the extent that such regulations do not significantly interfere with legitimate regulation of the same subject matter by the jurisdiction of incorporation or domicile.

Committee on International Law, Association of the Bar of the City of New York, *The 1964 Amendments to the Securities Exchange Act of 1934 and the Proposed Securities and Exchange Commission Rules—International Law Aspects*, 21 A.B. CITY N.Y. 240, 243-44 (1966) (emphasis added). "A short swing profit by the corporate insider—presumably legal under the laws of the jurisdiction of incorporation of the corporation—does not . . . have an effect within the United States which is substantial . . . 'direct and foreseeable' . . . merely because the corporation happens to have 300 United States [resident] shareholders." *Id.* at 250 (emphasis added). It is "essential to weigh the various interests involved, including of course not only the interests of the United States but of the international community as a whole and of the 'home' state of the foreign corporation." *Id.* at 251 (emphasis added). Basing applicability of the law on shareholder residence would mean that "a corporation, the shares of which were internationally owned, would be subject to the valid assertion of plenary jurisdiction to regulate its internal affairs by each state in which it happened to have shareholders [which is contrary to the principle of territoriality]." *Id.* at 252 (emphasis added). "[T]he Committee submits that compliance by the foreign corporation [having an 'inadvertent' contact with the United States] with the laws of the country of its incorporation comports more closely with the standards of comity which are the basis of international law than the assertion of jurisdiction by each country in which such corporation has shareholders." *Id.* (emphasis added) (footnote omitted).

shareholder decisionmaking.⁴⁵¹ Sections 14(a), (c), and (f) of the Act and the SEC Proxy Rules, in addition to controlling the content of disclosures and the manner of solicitation of proxies, also subject certain aspects of the voting procedures, shareholder proposals, inspection rights, and communications to substantive norms which would normally be categorized as internal affair rules.⁴⁵² The obligation of corporate management under section 13 of the Act to maintain records and to provide information for the benefit of the shareholders about the operations and financial condition of the corporation⁴⁵³ also does relate to internal affairs. So too does section 16, under which a corporate insider is required to report his acquisitions and, by virtue of his presumed access to confidential corporate information, disgorge to the corporation short-swing profits made by trading in its stock.⁴⁵⁴ The emphasis here is on the breach of fiduciary duty rather than on the effect on the market.

The registration requirements are the centerpiece of the Act's regulatory scheme.⁴⁵⁵ The provisions affecting internal affairs in sections 13, 14, and 16 apply only to those corporations that have "registered" securities under section 12.⁴⁵⁶ At first glance, place of incorporation and other corporate connections appear irrelevant, but four connections are used in the major exemptions from registration or from certain obligations: (a) place of incorporation, (b) residence of shareholders, (c) principal place of management, and (d) residence of directors. For example, only foreign private issuers, defined as corporations "incorporated or organized under the laws of any foreign country,"⁴⁵⁷ are eligible to use the available exemptions from the obligations of sections 12, 14, and 16.⁴⁵⁸ United States corporations are by definition excluded from this exemption. Also, compliance with the publicity requirements of the state of incorporation satisfies United States law in certain contexts.⁴⁵⁹ Thus, place of incorporation is an important threshold consideration in this area. It and

451. Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489, 1490 (1970).

452. 15 U.S.C. § 28n (a),(c),(f) (1982); 17 C.F.R. §§ 240.14a-1-11, 240.14c-1-7, 240.14f-1 (1984).

453. 15 U.S.C. § 78m (a)-(b) (1982).

454. 15 U.S.C. § 78p (a)-(b) (1982).

455. 15 U.S.C. § 78l (1982).

456. 15 U.S.C. §§ 78m (a)-(b), 78n (a)-(c), 78p (a) (1982). Such securities for section 12 purposes are (a) securities registered on a national securities exchange or (b) securities of a corporation in interstate or foreign commerce that has total assets exceeding \$3 million and is owned by at least 500 persons. 15 U.S.C. § 78l(b)(g) (1982) (section 78l(g) as currently enacted provides for an asset limitation of \$1 million but has been liberalized by 17 C.F.R. § 240.12g-1 (1984) which increases the asset limitation to \$3 million.)

457. See 17 C.F.R. § 240.3b-4(b) (1984).

458. See 17 C.F.R. § 240.12g3-2(a), (b), (d) (1984) (exemption from regulation under § 12(g) of the Act); 17 C.F.R. § 240.3a12-3(b) (1984) (exemption from § 14(a), (c), (f) and from § 16 of the Act).

459. See 17 C.F.R. § 12g3-2(b)(1)(i) (1984).

residence of shareholders are the most significant connections for section 12 purposes.

The courts generally have respected the spirit of nonextraterritoriality reflected in these provisions.⁴⁶⁰ Furthermore, in considering whether to impose additional limitations upon the transnational reach of provisions such as section 16(b), the courts appear to have been influenced by the place of incorporation.⁴⁶¹

Foreign corporations generally are exempted from the obligation to register a class of securities if fewer than 300 residents of the United States own securities of such class.⁴⁶² Furthermore, sections 14(a), (c), and (f) and section 16 do not apply to non-North American registered foreign corporations unless more than fifty percent of their voting stock is owned by United States residents and either (1) their principal place of management is in the United States, (2) a majority of their directors or executive officers reside in the United States or are United States citizens, or (3) more than fifty percent of their assets are located in the United States.⁴⁶³ In other words, having a substantial number of United States shareholders is a prerequisite to subjecting an unlisted foreign corporation to certain internal affairs obligations of the 1934 Act. Even then, however, the principal obligations—proxy regulation and disgorgement of short-swing profits—do not apply unless certain additional connections are present, including in large ownership of the voting stock by United States residents.

The proposed Federal Securities Code addresses the extraterritoriality question in section 1905. The general approach of the Code is to

460. See *Kohn v. American Metal Climax, Inc.*, 322 F. Supp. 1331, 1352 (E.D. Pa. 1971) (plaintiff shareholders of a foreign corporation did not claim violations of the proxy rules under §14(a) despite the extensive solicitation in the United States, apparently because the securities had not been registered. Because the solicitations related to a merger, § 10(b) was relied upon instead), *modified on other grounds*, 458 F.2d 255 (3d Cir. 1972); see also *Jordan v. Global Natural Resources*, 564 F. Supp. 59, 67 n.5 (S.D. Ohio 1983) (foreign corporation not subject to § 14(a) proxy rules because § 12(g)(3) specifically exempts foreign corporations from regulations under the proxy rules). Cf. *Ronson Corp. v. Liquifin Aktiengesellschaft*, 370 F. Supp. 597, 609-10 (D.N.J.) (foreign corporation did not violate § 14(e) since it made sufficient disclosure to shareholders), *aff'd*, 497 F.2d 394 (3rd Cir. 1974); *Travis v. Anthes Imperial, Ltd.*, 473 F.2d 515, 527-29 (8th Cir. 1973) (foreign corporation held liable under § 10(b) and rule 10b-5 since a decline in value of stock held by United States residents was a direct result of the corporation's misconduct).

461. See *Wagman v. Astle*, 380 F. Supp. 497, 502 (S.D.N.Y. 1974) (a Canadian corporation whose only act within the United States was registration with the SEC); *Roth v. Fund of Funds*, 279 F. Supp. 935, 938 (S.D.N.Y.) (corporation not exempted because buy and sell orders given from outside United States where New York was place of alleged wrong), *aff'd*, 405 F.2d 421 (2d Cir. 1968), *cert. denied*, 394 U.S. 975 (1969). See also Thomas, *Securities Regulators Grapple with Extraterritoriality*, *Legal Times*, Jan. 17, 1983, at 20, 23.

462. 17 C.F.R. § 240.12g3-2 (a) (1984).

463. 17 C.F.R. § 240.3a12-3(b) (1984).

require registration of all corporations, wherever situated, that meet certain asset and shareholding criteria similar to those of present section 12(g). But the SEC is empowered to exempt from registration issuers that are not "residents" of the United States,⁴⁶⁴ and residence for corporations is defined as the "place of organization or principal place of business."⁴⁶⁵ Thus, it appears that only corporations that are organized and have their principal place of business abroad may be exempted. What is noteworthy for our purposes is the prominence given to the place of incorporation and, more specifically, the absolute registration requirement for all corporations incorporated in the United States. The residence of directors has no bearing on the applicability of the Code to their corporations. In addition, the SEC has general authority to exempt all "persons," including possibly non-residents, from the application of certain specific provisions of the Code.⁴⁶⁶

The manner in which sections 12(g), 13, 14(a), and 16(b) of the Act have been applied extraterritorially under the present regime of registration and exemptions is basically consistent with the primacy of the lex incorporationis. Coverage extends to all corporations organized in the United States regardless of any other contacts. The main connection that brings foreign corporations within the reach of these provisions is majority or substantial shareholdings by United States residents, sometimes reinforced by major management contacts with the United States or national trading of their securities in the United States. These are strong links that trigger the protective interests of the United States. The limited nature of the interference with the internal affairs of the foreign corporation, the relative clarity and strength of the criteria used, and the adequacy of the prior notice given to the affected parties, make a good case that the present system is satisfactory under conflicts analysis.⁴⁶⁷

B. *The Impact on Internal Affairs of the Extraterritoriality of Section 10(b) and Rule 10b-5.*

The writings on the "extraterritoriality" of section 10(b) are legion.⁴⁶⁸ The common wisdom that the securities acts basically regulate transactions in securities and have only a tangential effect on most inter-

464. FED. SEC. CODE § 1905(c)(2) (Proposed Draft 1978).

465. FED. SEC. CODE § 299.44 (Proposed Draft 1978).

466. FED. SEC. CODE § 303 (Proposed Draft 1978).

467. The same cannot be said, however, of the introduction of the "principal business" connection as a basis for United States regulation under the Federal Securities Code because of its lesser relevance to issues of internal affairs.

468. See *infra* note 472. The subject is considered so important that the *Restatement of Foreign Relations Law of the United States (Revised)* (Tentative Draft No. 2) (1981) saw fit to include an entirely new Section 416 governing specifically "Jurisdiction over Securities Transactions."

nal corporate affairs extends to "securities fraud" under section 10(b) and Rule 10b-5 of the Act. It is only where shareholders are allowed to pursue remedies for fraud perpetrated upon the corporation itself that section 10(b) significantly intersects with internal affairs. There has never been much doubt that 10(b) claims may be pursued derivatively.⁴⁶⁹ But should such suits be treated as traditional derivative suits whose substantive aspects⁴⁷⁰ are governed by the internal affairs law of the corporation? Until 1977, the prevailing view was that, both in the domestic and in the international contexts, the pursuit of shareholder claims for securities fraud perpetrated on the corporation—at least where the corporate management was implicated—was a matter of 10(b) law, not of state corporate law.⁴⁷¹ Consequently, the international scope of such claims was to be handled under the extraterritoriality analysis applied in the ordinary 10(b) case.⁴⁷²

469. See *Ruckle v. Roto Am. Corp.*, 339 F.2d 24, 26 (2d Cir. 1964); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 462 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952); *Slavin v. Germantown Fire Ins. Co.*, 174 F.2d 799, 800 (3rd Cir. 1949); Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Mismanagement Cases*, 86 HARV. L. REV. 1007, 1020-22 (1973).

470. For discussion of the procedural aspects and especially the manner of application of rule 23.1 of the Federal Rules of Civil Procedure, see, *supra* note 91.

471. *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964) is one of the earliest cases to deal with this issue. A majority of the directors who authorized the issuance of shares to an insider had knowledge of important earnings information which they withheld from the minority directors. 339 F.2d at 26. Did this bar the corporate 10(b) claim? The court had no difficulty "in rejecting such cliches as the directors constitute the corporation and a corporation . . . cannot defraud itself. . . . Denial of relief on this basis would surely undercut the congressional determination [embodied in 10(b)]." 339 F.2d at 29. In *O'Neill v. Maytag*, 339 F.2d 764 (2d Cir. 1964), decided a few weeks later, the same court distinguished and significantly limited *Ruckle* to situations where at least some directors are deceived. 339 F.2d at 768. In subsequent years the view that commanded wider support was one protective along the lines of *Ruckle* rather than technical as in *O'Neill*. For a full review and analysis, see 2 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD § 4.7 (1984).

472. The most important early case on the "extraterritoriality" of derivative 10(b) actions is *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir.), *aff'd in relevant part & rev'd in part*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969). This was an action by an American shareholder on behalf of a Canadian corporation against foreign defendants for alleged 10(b) fraud—insiders' trading—committed in Canada. The only other United States connection, unrelated to the transaction, was that the stock was listed on the American Stock Exchange. The lower court came closer than any other court to the proper analysis of the issue. While it did refer to the rebuttable presumption of the territoriality of regulatory legislation, to the location of the harm in Canada, and to the failure of the SEC to make rules to protect the American markets in this kind of situation, the court correctly placed the principal emphasis on corporate conflicts of law and dismissed the claim on the ground that plaintiff had in reality alleged not securities fraud but corporate mismanagement which is governed by the law of incorporation under the internal affairs rule. 268 F. Supp. 385, 392-93 (S.D.N.Y. 1967).

The Second Circuit totally disagreed on this precise point, stressing the regulatory and protective nature of § 10(b) and the absence of SEC rules exempting application of the section in that instance. In the famous language repeated in many subsequent cases the court stressed that it believed "that Congress intended the Exchange Act to have extraterritorial application in order to

Then came the landmark case of *Santa Fe Industries v. Green*,⁴⁷³ which excluded corporate mismanagement in securities transactions from the ambit of section 10(b). This case would have practically eliminated derivative 10(b) claims involving internal corporate affairs had it not been for the "constructive deception" loophole opened by *Goldberg v. Merridor*⁴⁷⁴ and its progeny⁴⁷⁵ for situations where truthful information is not disseminated to disinterested parties within the corporation. In the *Goldberg* circumstances, the *Schoenbaum v. Firstbrook* approach⁴⁷⁶ would call for the international reach of the "constructive fraud" claim to be determined under 10(b) criteria without deference to the law governing the internal corporate affairs. A better approach was adopted by the lower court in *IIT v. Cornfeld*,⁴⁷⁷ in which a derivative 10(b) claim brought on behalf of a foreign corporation was dismissed because most of the shareholders were foreign nationals and residents: "Whatever the value or justification for 'federalizing' the law of corporate management in the domestic context, an extension of the law to 'Americanize' the corporations laws of the entire world is a different prospect."⁴⁷⁸ The court recognized that the internal relationship between directors and

protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities." 405 F.2d 200, 206 (2d Cir.), *aff'd in part & rev'd in part*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969). By reversing the lower court and holding that an American shareholder can assert a corporate 10(b) claim because of the indirect diminution of the value of his stock, regardless of the fiduciary law and the derivative suit requirements of the state of incorporation, 405 F.2d at 208-09, the Second Circuit recognized a special derivative action involving breaches of fiduciary duty as a matter of 10(b) law.

The extraterritorial dimension of *Schoenbaum* has been generally discussed in the literature without addressing its fiduciary and derivative aspects. See Goldman & Magrino, *Some Foreign Aspects of Securities Regulation: Towards a Reevaluation of Section 10 of the Securities Exchange Act of 1934*, 55 VA. L. REV. 1015, 1034-35 (1969); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 556-57, 563-68 (1976).

Application of Canadian fiduciary and derivative law most probably would have supported maintenance of the action in *Schoenbaum* leading to the same result. Subsequent cases on extraterritoriality have limited the scope of *Schoenbaum* to situations where the effects on United States securities markets are direct and substantial. See, e.g., *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1333 (2d Cir. 1972); see also *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 528 (8th Cir. 1973).

473. 430 U.S. 462 (1977).

474. 567 F.2d 209, 215-18 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

475. See, e.g., *Healy v. Catalyst Recovery, Inc.*, 616 F.2d 641, 647 (3rd Cir. 1980); *Alabama Farm Bureau Mut. Casualty Co. v. American Fidelity Life Ins. Co.*, 606 F.2d 602, 613 (5th Cir. 1979); *Kidwell ex rel. Penfold v. Meikle*, 597 F.2d 1273, 1290-92 (9th Cir. 1979); *Maldonado v. Flynn*, 597 F.2d 789, 792-95 (2d Cir. 1979).

476. 405 F.2d 200 (2d Cir.), *aff'd in part & rev'd in part*, 405 F.2d 215 (2d Cir.) (en banc), *cert. denied*, 395 U.S. 906 (1969).

477. 462 F. Supp. 209 (S.D.N.Y. 1978), *aff'd in part & rev'd in part*, 619 F.2d 909 (2d Cir. 1980).

478. 462 F. Supp. at 225.

shareholders is governed by the law of incorporation⁴⁷⁹ and that its applicability is consistent with the reasonable expectations of the parties.⁴⁸⁰ This is eminently sound. In what circumstances the knowledge of management should be imputed to the corporation is an internal affairs question whose determination under the applicable corporate law should precede the merits of the 10(b) claim. The Second Circuit Court of Appeals, however, reversed in part in a two-pronged unanimous opinion written by Judge Friendly that continued the *Schoenbaum* tradition.⁴⁸¹ The first prong stressed the existence of some contacts of the *fraud* with the United States.⁴⁸² But if the application of 10(b) in this area is intended to protect United States shareholders of domestic corporations, the contacts of the fraudulent transactions themselves with the United States should not have been treated as a key factor.⁴⁸³ The second prong of his opinion was on more solid ground. It recognized some relevance to the law of incorporation, but concluded that imposing liability on American defendants for the benefit of foreign shareholders, on deterrent or altruistic grounds, in no way offends the legitimate interests of the state of incorporation.⁴⁸⁴

C. *The Multinational Corporation and the Lex Incorporationis.*

The increasing number of multinational corporations active worldwide and the question of their relationships to the home and the host nation have provoked extensive and heated discussions in recent years. The main issues concern the external activities of these corporations and the reach of the regulatory authority of the various nations of contact

479. *Id.* at 224 n.35, 225, 226 n.40.

480. *Id.* at 226.

481. *ITT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980).

482. *Id.* at 918.

483. For a critique of the approach reflected in this prong, see Comment, *The Transnational Reach of Rule 10-b(5)*, 121 U. PA. L. REV. 1363 (1973).

484. 619 F.2d at 919-21. It should be noted that in establishing the "materiality" of the non-disclosures in the "constructive fraud" cases, the courts examine the availability of remedies under the applicable state law, usually that of the state of incorporation. In *Goldberg* itself, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978), in which a Panamanian corporation had its principal place of business in New York, the court, per Judge Friendly, found for the plaintiff because an injunction would have been available under New York law and was not apparently prohibited under the law of Panama. *Id.* at 215-20. Recognizing the existence of a "difficult choice-of-law issue," Judge Meskill dissented in part, questioning the applicability of New York law under *Hausman v. Buckley*, the Reese and Kaufman article, and *Santa Fe Indus. v. Green*. *Id.* at 221, 224 n.9 (Meskill, J., dissenting). Cases applying the law of incorporation on remedies for *Goldberg* purposes include *Healy v. Catalyst Recovery of Pa.*, 616 F.2d 641, 643, 648, 658 n.10 (3rd Cir. 1980) (Texas law) and *United Canso Oil & Gas Ltd. v. Catawba Corp.*, FED. SEC. L. REP. ¶ 99,482 (CCH) (D. Conn. 1983) (Canadian law). See also Ferrara & Steinberg, *The Interplay Between State Corporation and Federal Securities Law—Santa Fe, Singer, Burks, Maldonado, Their Progeny, & Beyond*, 7 DEL. J. CORP. L. 1 (1982).

under tax, antitrust, labor, investment, foreign exchange, import-export, anti-corruption, environmental protection, and other other criteria. One of the perennial problems in these fields—attributing a “nationality” to a corporation for purposes of controlling, as well as protecting, it in times of peace and of war—becomes especially difficult where not only its operations and assets but also its direct and indirect ownership and control are dispersed among many nations.

The question of what law should govern the internal affairs of these corporations hardly surfaces at all in these debates.⁴⁸⁵ There are plausible explanations for this indifference. First, the typical multinational corporation does not consist of one corporate entity but of a complex group of parents, subsidiaries, and affiliates, each of which is incorporated under and identified with the law of one country. Thus, there is no single internal corporate law governing the entire enterprise; the law applicable to each component unit can be determined under separate choice-of-law criteria. Second, it is generally assumed that the internal corporate relationship is of a private nature among the owners and managers of the enterprise and that the public policy objectives of the nations affected can be best pursued through external regulation and control rather than internal intervention. To be sure, such regulation and control need not respect the separateness of the legal entities composing the multinational enterprise. But any “piercing of the corporate veil” in this context need not, and typically does not, involve interference with the internal corporate relationship. Third, the effectiveness and practicality of relying on internal controls as means toward external ends is dubious.

There exists no general rule of international law that imposes an obligation on nations to recognize the personality of foreign corporations, subject them to any particular internal affairs regime, or permit them to do business within their territory. The *Restatement of the Law (Second): Foreign Relations Law of the United States*⁴⁸⁶ which attributes a “nationality” to corporations—an important jurisdictional connection in many external contexts⁴⁸⁷—uses the place of incorporation to deter-

485. The classical study of international corporate conflict of laws remains BADR, *ALIEN CORPORATIONS IN CONFLICT OF LAWS* (1953). The few more recent sources where some discussion of the conflicts issues is undertaken include Peterson, *The Law Applicable to Multinational Corporations from the Perspective of the United States*, in *LAW IN THE UNITED STATES OF AMERICA IN SOCIAL AND TECHNOLOGICAL REVOLUTION* 173 (N. Hazard & W. Wagner eds., 1974); Baade, *Multinational Corporations and American Conflicts Law*, 37 *Rabels Zeitschrift* 32 (1973) (in German with English summary); Hadari, *supra* note 45.

486. *RESTATEMENT OF THE LAW (SECOND): FOREIGN RELATIONS LAW OF THE UNITED STATES* (1965).

487. *RESTATEMENT OF THE LAW (SECOND): FOREIGN RELATIONS LAW OF THE UNITED STATES* §§ 37-40, 171-173 (1965).

mine such nationality.⁴⁸⁸ But the subject matter involves public regulatory legislation and has no relationship with internal affairs.⁴⁸⁹ Multilateral and bilateral treaties often provide for recognition of the legal personality of corporations and for their admission on national or most-favored-nation terms, but are equally silent on the law applicable to their internal affairs. Indeed, there is no indication that the "multinationalization" of corporate activity has significantly affected the corporate choice-of-law rules and principles applied by the various nations of the world, including the United States and Europe, to such enterprises.

Nevertheless, the restraints and limitations on a nation's power to extend its regulatory jurisdiction over foreign persons and events should apply *a fortiori* in the private law sphere; conflicts with other nations should be accommodated on the basis of comity.⁴⁹⁰ The host nation of a subsidiary of a multinational enterprise would normally apply its own corporate law to the internal affairs of the subsidiary and is in a position to check the potential abuses of the dominant foreign parent. It could, for example, impose strict fiduciary obligations on shareholders and managers and install other appropriate control mechanisms and procedures over affiliated enterprises. The greater the concentration of private power and the possibilities of evasion, the more stringent need be the rules. The same holds true for the home nation of the parent in regard to extraterritorial holdings and activities. When the parent proposes to enter a nation in its form of a foreign corporation, the local "qualification" or "domestication" statute may impose obligations and controls

488. RESTATEMENT OF THE LAW (SECOND): FOREIGN LAW OF THE UNITED STATES § 27 (1965). Cf. *Tagle v. Regan*, 643 F.2d 1058, 1063 (5th Cir. 1981) (corporation treated as entity); *United States v. Firestone Tire & Rubber*, 518 F. Supp. 1021, 1032, 1040 (N.D. Ohio 1981) (government asserts extraterritorial application of the gold regulations based on United States incorporation); *Carl Zeiss Stiftung v. V.E.B. Carl Zeiss*, 293 F. Supp. 892, 900 (S.D.N.Y. 1968) (although the foreign country may not be recognized by the United States, its law can still apply to its corporations).

489. The same is true of the RESTATEMENT OF FOREIGN RELATIONS LAW OF THE UNITED STATES (REVISED) § 216 (Tentative Draft No. 2 1981) which continues the reference to the *lex incorporationis* while recognizing some limitations on diplomatic protection. This revision reflects the holding in the *Barcelona Traction* case. 1970 I.C.J. 4, 43-45 (holding that Belgium could not sue Spain for injury to a Canadian corporation even though most of the company's shares were owned by Belgians). This draft adds a new section, dealing with jurisdiction to control the foreign subsidiaries of United States nationals, in which the law of the place of incorporation is determinative on certain issues of whether the United States may require or prohibit conduct. See Section 418(4)(a). For a critical view of this position, see Thompson, *U.S. Jurisdiction Over Foreign Subsidiaries: Corporate and International Law Aspects*, 15 LAW & POL'Y 319, 380-94 (1983).

490. In fact, the "reasonableness" test adopted in Tentative Draft number 2 to reduce conflicting or overlapping regulation—section 403(1)—is similar and reflects in many respects the "significant relationship" concept of RESTATEMENT (SECOND), *supra* note 46, § 6. See RESTATEMENT OF FOREIGN RELATIONS LAW OF THE UNITED STATES (REVISED) § 403 n.10, at 113-14 (Tentative Draft No. 2, 1981).

analogous to those suggested for the multistate corporation doing intrastate business within a state of the United States.

This is not to suggest that the development of an international system of controls is improper or inadvisable. The point is that the considerations that support the *lex incorporationis* domestically are even more compelling in the multinational context and presently nothing suggests the possibility of any departure from it. The fact that there is no general unification of corporate law, or even an agreement on corporate choice-of-law within federations, such as the United States, and within economic communities, such as the European Economic Community (EEC), indicates the satisfaction with the status quo or at least a lack of consensus for common action in this field. This observation is corroborated by the fact that neither the 1956 Hague Convention⁴⁹¹ nor even the EEC Convention on the Recognition of Companies,⁴⁹² which have incorporated relatively modest corporate choice-of-law rules, have been ratified as yet.⁴⁹³

VIII. CONCLUSION

Under the Constitution, a state has wide latitude in regulating the internal affairs of corporations connected with it. First, a state may apply its entire law to corporations incorporated in that state, whatever the locus of their other contacts, as well as to corporations, particularly pseudo-foreign ones, having predominant local contacts. The new antitakeover statutes—especially those provisions that control second-tier actions or impose shareholder approval requirements—and California's controls over certain foreign corporations probably fall within the ambit of these powers. Second, a state may require that intrastate operations be conducted in local corporate form either through domestication or by the

491. See *supra* note 245.

492. See *supra* note 246.

493. In a major study on the nationality of the multinational enterprise, Hadari reviewed the criteria used to subject a multinational corporation or its components to the laws and regulations of particular states and concluded that "it is impossible to have a single criterion for all purposes." Hadari, *supra* note 45, at 36. Hadari articulates three "guidelines" for determining corporate nationality: the needs of a workable international system, the protection of the justified expectations of the parties—particularly through certainty, predicatability, and non-interference—and the recognition of the justifiable national interest. *Id.* at 37-39. Hadari tests the guidelines in the narrower field of corporate choice-of-law for internal corporate affairs; his conclusions are closely modeled on the approach of the *Restatement (Second)* in that a rebuttable presumption in favor of the *lex incorporationis* is established which can be completely overcome or modified through selective intervention to vindicate a local interest. *Id.* at 44-47. He also comments favorably on the features of the draft EEC Convention which allows local interventionism only by the state or states which have the principal or a substantial connection with the corporation. *Id.* In general, these guidelines are sound and the positions taken in this article are consistent with them.

formation of a local subsidiary. This represents a major power but has been scarcely utilized in the past. Third, conventional wisdom holds that intrastate sales of securities may be subjected to local blue-sky law, including fairness requirements.

At the other end of the spectrum, the full faith and credit clause as applied in *Wolfe* and the negative operation of the commerce clause under *Edgar* prohibit the states from directly regulating the entire internal affairs of genuinely foreign corporations, even where such corporations have some significant local contacts. The imperative of applying a single, constant law to the entire bundle of internal rights and obligations and to corporate governance weighs heavily against any attempts at fragmentation and piecemeal intervention. For example, although a state has the power to apply its corporate policy concerning resident shareholders, it may neither burden interstate commerce unduly nor ignore the unity of the internal corporate relationship in violation of the full faith and credit clause. In the ordinary case, interference based on shareholder residence will be constitutionally impermissible except that, given the centrality of the shareholder connection, the state of residence of all or almost all the shareholders can make a plausible claim that it is the state of the predominant contacts and thus assert total internal affairs authority.

The power of the state in which business is transacted to interfere in "hard core" internal affairs ordinarily should be minimal. But when it comes to provisions limiting management prerogatives principally for the protection of creditors—such as prohibiting distributions impairing capital—the local interest connected to local business is strong, and the imposition of liability does not heavily burden internal affairs. Governance and structure are not affected, shareholder equality is not compromised, and compliance is quite practical. Using this kind of analysis, a credible case can be made that the basic New York controls over the internal affairs of foreign corporations are valid. For the inspection of corporate records under local law as provided in New York and California, however, only the practicality argument, an artificial "local asset" characterization, and the presence of some other secondary contacts are available as justification. This article suggests that, given clearly internal subject matter, these provisions are of dubious constitutionality.

While a state has unlimited authority to exclude a foreign corporation from intrastate business or local sales of securities and, consequently, to extract conditions as the price of admission, such conditions, at least when not related to the intrastate connections, may not include waivers of constitutional rights. Thus, it is quite doubtful that a state

may condition entry on the subjection of out-of-state operations, transactions, or relationships, including internal corporate affairs, to local rules.

Under the prevailing conflicts practice, neither courts nor legislatures have maximized the imposition of local corporate policy on foreign corporations but have consistently applied the law of the state of incorporation to the entire gamut of internal corporate affairs. In many cases, this is a wise, practical, and equitable choice. It serves the vital need for a single, constant and equal law to avoid the fragmentation of continuing, interdependent internal relationships. The *lex incorporationis*, unlike the *lex loci delicti*, is not a rule based merely on the *priori* concept of territoriality and on the desirability of avoiding forum-shopping. It validates the autonomy of the parties in a subject where the underlying policy of the law is enabling. It facilitates planning and enhances predictability. In fields like torts, where the typical dispute involves two persons and a single or simple one-shot issue and where the common substantive policy is to spread the loss through compensation and insurance, the preference for forum law and the emphasis on the state interest in forum residents which are the common denominators of the new conflicts methodologies do not necessarily lead to unacceptable choices. By contrast, applying local internal affairs law to a foreign corporation just because it is amenable to process in the forum or because it has some local shareholders or some other local contact is apt to produce inequalities, intolerable confusion, and uncertainty, and intrude into the domain of other states that have a superior claim to regulate the same subject matter. Fortunately, such an intervention would usually be precluded by constitutional considerations.

In the international context, certain provisions of the federal securities laws that regulate proxy solicitations, disgorgement of insiders' profits, and disclosure of information sufficiently implicate internal corporate affairs to require a conflicts analysis. While the basic line of demarcation is properly drawn at the place of incorporation and domestic companies are always included, the net sometimes catches foreign corporations having a number of shareholders residing in the United States. Under our previous analysis, this single connection is insufficient to support substantial internal affairs regulation; the only explanation that has some acceptability is that the obligations imposed are limited and directly relate to the protection of the interests of the local shareholders. Such an explanation is stronger in those instances where majority United States shareholdings or other major contacts are additionally required. The determination of when a corporation is deceived or defrauded in a securities transaction where management is implicated again involves an internal affairs question and reference should be made to the law of

incorporation. The courts, however, have failed to make the necessary distinctions and are treating it under the usual criteria of section 10(b) extraterritoriality which revolve around the place where the conduct took place or the effects were experienced.

Finally, the multinational corporation has not to date created serious problems in choice of law for internal corporate affairs because it usually operates through local subsidiaries subject to local corporate law and because it can easily structure its affairs to be governed by the *lex incorporationis* thereby bypassing any other law such as that of the real seat. The various plans and ideas for the host states to tame the multinationals stress external and not internal controls.