The Internal Affairs Doctrine: The Proper Law of a Corporation

Norwood Beveridge
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By Norwood P. Beveridge, Jr.*

In a much-discussed decision striking down an Illinois takeover statute as unconstitutional, the United States Supreme Court rejected an argument by the Illinois Secretary of State that the statute was justified by the state’s interest in regulating the internal affairs of corporations incorporated under its laws. Noting that the statute by its terms also applied to corporations not incorporated in Illinois and having their principal places of business in other states, the Court stated:

The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation’s internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands. . . . Illinois has no interest in regulating the internal affairs of foreign corporations.1

The Court also stated that the proposed justification was not convincing even for Illinois corporations:

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1. Edgar v. MITE Corp., 457 U.S. 624, 645–46 (1982). The Court concluded that the statute imposed a substantial burden on interstate commerce in the purchase and sale of securities which outweighed its putative local benefits and was accordingly invalid under the commerce clause of the U.S. Constitution. Id. at 646. Since the target company in the case, Chicago Rivet & Machine Co., was a publicly held Illinois corporation, the above-quoted language is dictum. It is fair to say that the case is confusing. See Regan, The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause, 84 Mich. L. Rev. 1091, 1278–83 (1986).
Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company.\(^2\)

This latter reasoning caused one scholar to sound the alarm, saying "No case or commentator seems to notice the rather startling potential for commerce clause claims in corporate law after MITE.\(^3\)" He suggested that several other state-created internal affairs rules (such as supermajority voting requirements) might have become suspect as interfering with interstate tender offers.

The Supreme Court should have put that question to rest in its next decision when it upheld the Indiana Control Share Acquisitions Act against preemption and commerce clause challenges.\(^4\) There, the Court in its preemption decision found no evidence that Congress in enacting the Williams Act intended to preempt all state laws, such as staggered terms for corporate directors, that could delay a tender offer.\(^5\) With respect to the commerce clause, the Court once again turned to the internal affairs doctrine, this time to justify Indiana's regulation of the voting rights of shares in Indiana corporations:

So long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State . . . This beneficial free market system [for trading in corporate securities] depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.\(^6\)

The district court had pointed out that the Indiana statute might have been intended to regulate tender offers for foreign corporations, but the Supreme Court disagreed.\(^7\) In any event, because the target corporation, CTS Corporation, was an Indiana corporation, the Court was not required to reach the question of whether a control shares statute could be applied to a foreign corporation with local contacts.

Some state takeover statutes unambiguously apply to foreign corporations with local shareholders, employees, and business.\(^8\) Thus, the immediate ques-

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2. 457 U.S. at 645 (citing Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1280 n.53 (5th Cir. 1978), rev'd on other grounds sub nom. Leroy v. Great W. United Corp., 443 U.S. 173 (1979), and Restatement (Second) of Conflict of Laws § 302 comment e (1971)).


tions is whether these statutes can be justified under the Supreme Court’s internal affairs commerce clause analysis. Using the internal affairs commerce clause analysis, a U.S. district court has already struck down the application of the Oklahoma Control Shares Act to a foreign corporation. That court held that the provision of the statute allowing the foreign corporation to “opt out” of the statute represented a further prohibited regulation of the internal affairs of a foreign corporation. In another case, while holding that a tender offeror for a domestic Massachusetts corporation could not raise the issue, the U.S. Court of Appeals for the First Circuit has indicated that applying the Massachusetts statute to foreign corporations “would not likely survive Commerce Clause analysis under CTS.”

The broader question of the validity under this kind of commerce clause analysis of any kind of regulation of the internal affairs of a foreign corporation has also been raised. Professor Buxbaum has concluded on this issue that “this


approach, the constitutional ‘Delawarization’ of state corporation law, is not what CTS intends or effects.\footnote{12}

This article intends to demonstrate that the so-called “internal affairs doctrine” has three distinct aspects, only one of which involves the choice of governing law in the generally accepted sense and none of which should prevent the continued regulation of the internal affairs of foreign corporations in the many accepted ways host states have done so in this century. The three aspects of the internal affairs doctrine are: (i) forum selection; (ii) choice of governing law; and (iii) forum “outreach” statutes.

**INTERNAL AFFAIRS AS A FORUM SELECTION DOCTRINE**

The traditional analysis of the internal affairs doctrine holds that it began with concepts of lack of jurisdiction and practical limitations on enforcing equity decrees out of state.\footnote{13} The early New York cases are typical.\footnote{14} There was no general agreement on the definition of “internal affairs,” and Justice Cardozo opined in 1915 that to undertake an enumeration of when jurisdiction would and would not be entertained “would be a difficult and hazardous venture.”\footnote{15} An early definition put forward by the Court of Appeals of Maryland was too general to be of much help.\footnote{16}

In *Rogers v. Guaranty Trust Co.*,\footnote{17} the United States Supreme Court established the general rule that state and federal courts would leave to the courts of


\[\footnotesize{\text{13. For a thorough review of the cases, see Annotation, Jurisdiction of Action or Proceeding Involving Internal Affairs of Foreign Corporation, 18 A.L.R. 1383 (1922), and supplements 89 A.L.R. 736 (1934) and 155 A.L.R. 1231 (1945); Reese, Full Faith & Credit to Foreign Equity Decrees, 42 Iowa L. Rev. 183 (1957).}}\]


\[\footnotesize{\text{16. That, where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders' meeting, or through its agents, the board of directors, then such action is the management of the internal affairs of the corporation, and, in case of a foreign corporation, our courts will not take jurisdiction.}}\]

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

\[\footnotesize{\text{17. 288 U.S. 123, 130 (1933) (suit to cancel issuance of stock dismissed). The general rule in Rogers soon found an exception in Harr v. Pioneer Mechanical Corp., 65 F.2d 332, 334 (2d Cir.), cert. denied, 290 U.S. 673 (1933), on the basis of the totality of New York contacts with the Delaware corporation.}}\]
the state of domicile suits concerning the internal affairs of a corporation. However, this general rule was soon abandoned.\footnote{18}

The general rule made no sense as applied to a corporation organized in a foreign state but having all of its shareholders, directors, officers, assets, and business in the forum state. A Note in the Harvard Law Review in 1931 concluded: "The vague principle that courts will not interfere with the internal affairs of a corporation whose foreignness is at best a metaphysical concept, must fall before the practical necessities of the modern business world.\footnote{19}"

While the courts continued to wrestle with difficult distinctions in the early decades of this century,\footnote{20} by the 1950s it had become reasonably clear that the exercise of jurisdiction vel non in the internal affairs cases had become a branch

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  \item \footnote{19} Note, Jurisdiction to Liquidate the Affairs of a Foreign Corporation on a Stockholder's Bill, 44 Harv. L. Rev. 437, 439 (1931); Scholl v. Allen, 237 Ky. 716, 36 S.W.2d 353, 358 (1931). See also Annotation, Dissolving or Winding Up Affairs of Corporation Domiciled in Another State, 19 A.L.R.3d 1279 (1968); Horton v. Hydra Sys. Int'l, 16 Conn. App. 420, 547 A.2d 926 (1988) (court has jurisdiction to appoint receiver for foreign corporation).
  \item The problem of the "tramp" or "pseudo-foreign" corporation is a recurring one in the internal affairs field. The courts have not shown the usual deference to the state of incorporation here. The Restatement of Conflict of Laws § 197 (1934) provided:

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Principal Business Carried on in State. Subject to the considerations stated in the Scope Note to this Topic, if the business of a foreign corporation is carried on entirely or principally in the state of suit, and if the directors of the corporation or a majority of them reside in the state or if they are accustomed to hold their meetings in the state, a court will entertain a shareholder's suit concerning management. The court will apply the law of the state of incorporation to determine how the business of the corporation shall be managed.
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of the law of forum non conveniens. As to this point, the Restatement (Second) of Conflict of Laws provides as follows:

Internal Affairs of Foreign Corporation. A court will exercise jurisdiction over an action involving the internal affairs of a foreign corporation unless it is an inappropriate or an inconvenient forum for the trial of the action.

Internal affairs are further described as "the relations inter se of the corporation, its shareholders, directors, officers or agents."

The more recent New York cases, which are illustrative, all apply the forum non conveniens test to determine whether jurisdiction will be retained; however, retaining jurisdiction does not mean that New York substantive law will be applied. Internal affairs as a choice of governing law doctrine still posits as the general rule that the state of incorporation will generally govern questions of internal affairs. We will next examine this rule and its exceptions.

INTERNAL AFFAIRS AS A CHOICE OF GOVERNING LAW DOCTRINE

The general choice of law rule with respect to the internal affairs of a corporation is set out in the Restatement (Second) of Conflict of Laws:

Sec. 302. Other Issues with Respect to Powers and Liabilities of a Corporation.


22. Restatement (Second) of Conflict of Laws § 84 comment d (1971).


24. "One of the abiding principles of the law of corporations is that the issue of corporate governance, including the threshold demand issue, is governed by the law of the state in which the corporation is chartered, in this case, Delaware." Hart, 129 A.D.2d at 182, 517 N.Y.S.2d at 492. The Hart court is not correct in saying that this principle defers to "the decision by shareholders to incorporate under the law of one jurisdiction." Id. at 185, 517 N.Y.S.2d at 493. Surely this decision in a public corporation is made by the promoters-incorporators or incumbent management, although in the case of reincorporation or merger it may require shareholder approval.

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(1) Issues involving the rights and liabilities of a corporation, other than those dealt with in Sec. 301 [relations with third parties], are determined by the local law of the state which, with respect to the particular issue, has the most significant relationship to the occurrence and the parties under the principles stated in Sec. 6.  

(2) The local law of the state of incorporation will be applied to determine such issues, except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship to the occurrence and the parties, in which event the local law of the other state will be applied.

Few cases have applied nonstatutory forum law over the law of the state of incorporation despite this invitation by the Restatement to do so in an unusual case. However, the New Jersey Supreme Court did so in *Francis v. United Jersey Bank*, where it applied New Jersey law rather than New York law to determine the liability of the director of a New York corporation for breach of the duty of care. The significance of the case is diminished since no difference was shown between New York and New Jersey law on the subject; in fact, the trial court found that they were the same.

A U.S. district court in New Jersey has followed the *Francis* case in deciding that the question of the liability of officers of a Utah corporation for insider trading in the stock of their corporation would be decided under New Jersey, not Utah, law in a stockholders' derivative suit.

The State of New York might have been thought a likely jurisdiction for adoption of a "significant contacts" approach to choice of law questions in a

25. Restatement (Second) of Conflict of Laws § 6 (1971) says two things: (i) Apply any local statute that is applicable, subject to constitutional constraints; and (ii) apply a list of seven enumerated factors to determine governing law where there is no local statute.


28. 162 N.J. Super. at 374, 392 A.2d at 1242.

corporate setting, as it had been an early convert to the new approach in contract and tort settings. In fact, in a suit involving a Massachusetts business trust, the New York Court of Appeals announced that it was prepared to follow such an approach in an appropriate case, which has so far not presented itself. Moreover, in deciding the validity under Delaware law of a close corporation election which had not been perfected by filing as required by the Delaware statute, the New York Court of Appeals noted that the "sterilization" of the board of directors of a Delaware corporation by shareholder agreement did not offend the public policy of New York, which also allowed this result in close corporations.

A recent case came close to deciding that New York was ready to adopt the significant contacts approach in a corporate setting. In that case, Norlin Corporation, a Panama corporation with its principal place of business in New York, had issued a large block of Norlin stock to Andean Enterprises, Inc., also a Panama corporation and a wholly-owned subsidiary of Norlin. The object presumably was to create a block of stock which could be voted by Norlin directors to perpetuate their control of the corporation. Under section 612(b) of the New York Business Corporation Law, shares of a corporation held by its majority-owned subsidiary are not deemed outstanding and are not entitled to vote. Panama had an identical law, but it only applied to "registered" and publicly traded corporations, and the evidence showed that Norlin was neither. Strangely, the New York Court of Appeals decided that, because the Panama statute was inapplicable, Panama had no interest in applying its law to the issue and that thus a false conflict was presented, leaving New York as an interested state free to apply its own law. Yet, the correct analysis was that since the voting was not prohibited under Panama law, it was permitted, and a true conflict of laws was presented calling for a resolution.

34. See Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255 (2d Cir. 1984). The Second Circuit had previously decided that New York showed no signs of choosing this option. See Hausman v. Buckley, 299 F.2d 696 (2d Cir.), cert. denied, 369 U.S. 885 (1962) (following New York choice of law rules to apply Venezuelan law to the right of a stockholder in a Venezuelan corporation to bring a derivative suit). See also Annotation, What Law Governs as to Shareholder's Right to Maintain Derivative Action, 93 A.L.R.2d 1354 (1964); Galef v. Alexander, 615 F.2d 51, 58 (2d Cir. 1980) (applying Ohio law under both traditional and grouping of contacts approaches).
35. 744 F.2d at 264.
The lapse of logic in the *Norlin* case was pointed out by the Delaware Supreme Court, which declined to follow the *Norlin* decision in a case presenting a very similar fact pattern. The plaintiffs were minority shareholders in McDermott, a Delaware corporation, who were seeking to set aside a reorganization pursuant to which McDermott became a ninety-two-percent-owned subsidiary of McDermott International, a Panama corporation. McDermott emerged from the reorganization owning ten percent of the stock of McDermott International. Again the issue presented was whether or not McDermott could vote the stock it held in its parent corporation. This time, three experts on Panama corporate law testified that since McDermott International was not registered or publicly traded, the statute forbidding voting did not apply, and therefore under Panama law, the shares could be voted. After the appeal had been argued, McDermott registered with the National Securities Commission of Panama, thereby making the Panama statute applicable and the appeal moot. However, the Supreme Court of Delaware said that the issues were so important that it would decide the case anyway on the basis of the facts at trial. Citing both *MITE* and *CTS*, the Delaware court held not only that it would apply the traditional choice of law rule that the laws of Panama as the jurisdiction of incorporation would govern but also that this result was commanded by the due process and commerce clauses of the U.S. Constitution.

This is certainly a different tone from the one the court had sounded only a few years earlier. In upholding a Delaware statute giving Delaware courts personal jurisdiction over directors of Delaware corporations, the court had justified the statute by the state's interest in having Delaware courts oversee the fiduciary duties of Delaware's corporate directors. The court warned that "choice of law analysis, either traditional or modern, does not inexorably lead to the application of Delaware law in such cases."

37. Id. at 210-11.
38. Id. at 215.
39. Id. at 218-19. The Supreme Court would also have invoked the full faith and credit clause but for the fact that a Panama corporation was involved. Id. at 219 n.16.
40. Armstrong v. Pomerance, 423 A.2d 174 (Del. 1980). The Delaware statute at issue in *Armstrong* had been passed as a result of the decision in *Shaffer v. Heitner*, 433 U.S. 186 (1977). In *Shaffer* the Supreme Court struck down the earlier Delaware statute which allowed jurisdiction over officers and directors of Delaware corporations to be obtained by sequestration of their stock in the corporation. The Court reasoned that Delaware could not obtain personal jurisdiction over these officers and directors merely by controlling their liability for breach of their fiduciary duty. Id. at 215. The Court further stated: "The rationale for the general rule [of internal affairs] appears to be based more on the need for a uniform and certain standard to govern the internal affairs of a corporation than on the perceived interest of the State of incorporation." Id. at 215 n.44.
41. 423 A.2d at 177.
INTERNAL AFFAIRS AS AFFECTED BY FORUM "OUTREACH" STATUTES

By far the most significant area of forum state governance of the internal affairs of foreign corporations is that of state outreach statutes specifically applicable to foreign corporations. These statutes are common in all jurisdictions in the United States and have been for the last century. For the most part, they have survived significant constitutional objections.42

The constitutional basis for such regulation was said to be based on an early Supreme Court decision that a corporation was not a citizen of the United States for purposes of the privileges and immunities clause and was therefore not entitled to be admitted into a state other than the state of its incorporation for the purpose of doing local business.43 Because the foreign corporation could be excluded altogether, it could be admitted upon terms, including a requirement that it reincorporate locally.44 However, some restrictions on the power to dictate terms were recognized. For instance, the state could not require a foreign corporation to give up its right to remove local suits to federal courts or revoke its license to do business within the state because it had filed an original suit in federal court.45 Interference with purely interstate commerce, as by denying access to local courts for unqualified foreign corporations, is not permitted.46 However, foreign corporations engaged in intrastate activity can be denied access to local courts for failure to qualify.47


The Model Business Corporation Act ("Model Act") recognizes the state's authority to require qualification of foreign corporations engaged in intrastate business. However, section 15.05(c) provides as follows:

This Act does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state.

The Official Comment states as to this provision:

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. Some states have adopted provisions similar to section 15.05(c), which is derived from earlier versions of the Model Act and originally from the Illinois corporate statute which served as the model for much of the original Model Act. Some writers have suggested that this language does no more than codify the general doctrine of lack of visitorial power discussed above. Section 15.05(c) does not prevent a forum court from taking jurisdiction in a suit involving the internal affairs of a foreign corporation or prevent a court from applying to a foreign corporation a local statute governing the rights of shareholders. Some of the more significant cases upholding the application of forum outreach statutes to foreign corporations are listed below:

(i) A California statute provided that the shareholders of domestic corporations and foreign corporations doing business in California should be personally liable, pro rata to their shareholdings, for all debts and liabilities of the corporation. The application of the statute to shareholders of a Colorado corporation which did business in California was upheld against a claim that the statute impaired the contract of the shareholders made in Colorado because the laws of Colorado provided no such liability, and that the statute violated

49. Model Business Corporation Act § 15.05(c) (3d ed. 1985).
article I, section 10 of the U.S. Constitution and the due process and equal protection clauses of the 14th amendment.56

(ii) A New York statute provided that dividends could be paid only out of surplus and not out of capital and that the corporation could sue to recover the amount of the unlawful dividends from the directors authorizing the unlawful payment. The statute was upheld as applied to a suit by a New Jersey corporation doing business in New York against directors who had authorized dividends out of capital. The dividends were also unlawful under New Jersey law, but the New Jersey statute gave a remedy only to the shareholders, not to the corporation unless it were insolvent, which was not the case here.57

(iii) A Wisconsin statute provided for liability of the shareholders of “every corporation,” pro rata to the amount of their shareholdings, for the unpaid debts of the corporation to employees for services, up to a maximum of six months’ wages. Delaware had no similar statute. The application of the statute to shareholders of a Delaware corporation doing business in the state was upheld.58

(iv) An Oklahoma statute gave shareholders the unqualified right to inspect corporate records. The statute was upheld in its application to a Delaware corporation with its principal business in Oklahoma as against an argument that Delaware law allowed such inspection only for a proper purpose, which had not been shown.59

(v) An Iowa statute provided that foreign corporations operating a public utility business within the state must comply with local statutes regarding consideration for the issuance of stock. The Iowa Code provided that stock could not be issued until the corporation had received par value and that if consideration other than money was to be received, permission must be received from the

56. Pinney v. Nelson, 183 U.S. 144 (1901). See also Thomas v. Matthiessen, 232 U.S. 221 (1914) (same statute as applied to shareholders in an Arizona corporation). The charters of both corporations recited that business would be done both in the state of incorporation and in California.

57. German-American Coffee Co. v. Diehl, 216 N.Y. 57, 109 N.E. 875 (1915). Justice Cardozo wrote the opinion and stated:

In these days, when countless corporations, organized on paper in neighboring states, live and move and have their being in New York, a sound public policy demands that our Legislature be invested with this measure of control. If the control is irksome, it may be avoided by leaving us.

216 N.Y. at 64, 109 N.E. at 877. The case is cited favorably in International Harvester Co. v. Wisconsin Dept. of Taxation, 322 U.S. 435, 442 (1944) for the proposition that a state may regulate to some extent the declaration of dividends by a foreign corporation. See also In re Burnet-Clark, Ltd., 56 F.2d 744 (2d Cir. 1932) (directors of Maryland corporation doing business in New York liable for share buyback out of capital which was illegal under New York law); International Ticket Scale Corp. v. United States, 165 F.2d 358 (2d Cir. 1948) (New York statute barring dividend applies to Delaware corporation even where dividend lawful under Delaware law).


executive council. A citizen's complaint in an action brought on behalf of the state of Iowa to declare void stock issued in a reorganization by a Delaware corporation without compliance with the Iowa statute was upheld as sufficient, and after trial the stock was held void.\textsuperscript{60}

(vi) A New York statute provided that foreign corporations doing business in New York were subject to a provision of New York law which allowed a shareholder to bring a shareholders' derivative action in the right of the foreign corporation to procure a judgment in its favor and that the shareholder must prove contemporaneous ownership of stock and a prior demand on the board of directors or an excuse for not making such demand. In a suit on behalf of a Panama corporation, it was held that New York internal corporate law excusing such demand upon a showing of futility governed over inconsistent Panama law requiring a resolution authorizing the suit to be adopted by a vote at a general meeting of shareholders.\textsuperscript{61}

(vii) A New York statute required a plaintiff in a shareholders' derivative suit to post a bond to reimburse the corporation and other defendants in the suit for their attorneys' fees and reasonable expenses if the defense was successful. This statute applied to shareholders of foreign corporations even if the state of incorporation had no similar statute.\textsuperscript{62}

(viii) A California statute provided that if a foreign corporation has more than half of its voting stock held by California residents and if more than half of its assets, payroll, and sales are within California, then specified aspects of its internal affairs will be governed by California domestic law "to the exclusion of the law of the jurisdiction in which it is incorporated." Exemptions are provided

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60. State ex rel. Weede v. Iowa S. Utils. Co., 231 Iowa 784, 2 N.W.2d 372, modified, 231 Iowa 784, 4 N.W.2d 869 (1942). See also State ex rel. Weede v. Bechtel, 239 Iowa 1298, 31 N.W.2d 853 (1948), cert. denied, 337 U.S. 918 (1949); Annotation, Statutory Requirements Respecting Issuance of Corporate Stock as Applicable to Foreign Corporation, 8 A.L.R.2d 1185 (1949). In language reminiscent of Justice Cardozo in German-American Coffee Co. v. Diehl, the Iowa Supreme Court stated in Bechtel:

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


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for most publicly owned corporations. Application of the statute to require cumulative voting in the election of directors of a Utah corporation was upheld against challenges based on the full faith and credit, commerce, due process, and equal protection clauses of the U.S. Constitution.63

(ix) A Delaware corporation with its principal operations and about thirty percent of its shareholders in California amended its charter to eliminate cumulative voting in the election of directors. A California court upheld the


A corporate fish was soon caught in the new California § 2115 net. The management of Arden-Mayfair, Inc., a publicly-held Delaware corporation, emerged the victor in a proxy contest for control of Arden's board of directors with the Louart Corporation, its largest shareholder, at its 1976 annual meeting of shareholders. See Kass v. Arden-Mayfair, Inc., 431 F. Supp. 1037 (C.D. Cal. 1977). Section 2115 became effective January 1, 1977. Louart therefore notified Arden-Mayfair that at the 1978 shareholders' meeting, election of directors should be of a non-classified board elected by cumulative voting (which would give Louart at least two out of the nine Arden board seats) rather than a classified board elected by straight voting as provided in the corporation's charter. In early 1977, Arden filed an action against Louart in Delaware and Louart filed an action against Arden in California. Arden held no shareholders' meeting in 1977. On March 15, 1978, the Delaware court held that under Shaffer v. Heitner, 433 U.S. 186 (1977), it had no jurisdiction over Louart, whose only connection with Delaware was being a shareholder in a Delaware corporation. Arden-Mayfair, Inc. v. Louart Corp., 385 A.2d 3 (Del. Ch. 1978). Arden's chairman, Curtis Palmer, had also filed a shareholder's suit against Arden in Delaware seeking declaratory relief. At the parties' request, the Delaware court appointed amicus curiae to oppose the petition. On April 25, 1978, the California court filed findings of fact and conclusions of law holding the California statute unconstitutional as in violation of the full faith and credit and commerce clauses, relying on Horowitz, The Commerce Clause as a Limitation on State Choice-of-Law Doctrine, 84 Harv. L. Rev. 806 (1971) and Reese & Kaufman, The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit, 58 Colum. L. Rev. 1118 (1958). See also unreported decision of the Delaware court in Palmer v. Arden-Mayfair, Inc., No. 5549, slip op. (Del. Ch. July 6, 1978). Various other litigation was filed, but in 1979, a settlement agreement was reached under which Arden would buy all of Louart's Arden stock for about $2.6 million and pay Louart $650,000 additional to settle all outstanding suits. Annual Report of Arden-Mayfair, Inc. on form 10-K for the fiscal year ending December 30, 1978, SEC File No. 1-5281, item 15(f), at 56-57. See also H. Henn & J. Alexander, supra note 42, § 98, at 222-23 n.54.
California Commissioner of Corporations in his ruling that this violated California's blue sky laws since any change in the rights of shareholders was a "sale" of the underlying stock under California law and therefore required a permit. The commissioner had refused to give a permit because he ruled that the plan was not "fair, just or equitable" to the affected shareholder.64

This last case, Western Air Lines v. Sobieski, is the most discussed case in this area, but because of its unusual nature, it is also the most easily misunderstood. At the annual meeting of shareholders of Western Air Lines ("Western") in 1956, a group of minority shareholders through cumulative voting elected two directors to Western's fifteen-member board. Western management promptly called a special shareholders' meeting to amend the charter to eliminate cumulative voting. The California Commissioner of Corporations then sent the company a letter advising that a permit would be required under section 25009(a) of the California Corporations Code, which provided: "Sale [of a security] or 'sell' includes...any change in the rights, preferences, privileges, or restrictions on outstanding securities."65 Section 25510 of the code provided: "After such hearing the commissioner may refuse to issue the permit authorizing such exchange if in his opinion the plan is not fair, just, or equitable to all securities holders affected."

At the special shareholders' meeting, the amendment was approved by sixty percent of the shares outstanding. However, in early 1958, after various procedural moves, the commissioner denied a permit for the amendment. Western filed for review in the California Superior Court, Los Angeles County, which by order entered in July 1958 held that the commissioner had acted in excess of his jurisdiction.66


65. This language was added in 1945, but it codified an interpretation of the Code dating to 1932. I H. Marsh & R. Volk, Practice Under the California Securities Laws § 1.03(1)[d], at 1-8 (1988). This was an unusual provision. Section 401(j)(6)(c) of the Uniform Securities Act adopted in 1956, as amended in 1958, had followed the lead of the Securities and Exchange Commission, which had adopted a "no sale" rule for securities issued in shareholder-approved mergers and reorganizations in 1951, then-rule 133, 17 C.F.R. § 230.133. Following the SEC's abandonment of the "no sale" rule in 1972 through the adoption of rule 145, 17 C.F.R. § 230.145, the Uniform Securities Act was amended in 1985. See § 402(17). California was virtually alone in its expansive definition of "sale." See Orschel, Administrative Protection for Shareholders in California Recapitalizations, 4 Stan. L. Rev. 215, 218-19 (1952). Orschel also wrote: "However, the Commissioner has never asserted jurisdiction over the recapitalization of a foreign corporation, probably because of the practical difficulty of enforcement." Id. at 219.

Following their earlier victory before the commissioner, the two dissident directors had filed suit in Delaware to compel an election of directors of Western. In the interests of comity, the Delaware court had withheld its decision, but following the superior court decision had ordered a special meeting of shareholders for the election of directors based upon straight, not cumulative, voting; the Delaware action was then dismissed.

A new Commissioner of Corporations, John G. Sobieski, took office in January 1959. He joined forces with attorney general Stanley Mosk and Professor Richard W. Jennings of the University of California, Berkeley, to mount a successful appeal of the superior court decision. The decision on appeal did not arrive until April 1961, but it was unanimous and the California Supreme Court denied Western's petition for a hearing.

Once again, on remand, the superior court held for Western, this time ruling that the commissioner had not given Western a fair hearing. Once again, on appeal, the lower court was reversed and the case remanded with directions to affirm the commissioner's order denying a permit.

If the Commissioner's position is sustained, it will clear up existing doubts as to the power of the Commissioner to impose reasonable conditions upon foreign corporations who choose to market their securities in California and to supervise voluntary reorganizations, recapitalizations, and mergers. It will also point the way for a state to use a securities statute as a regulatory device to prevent the circumvention of its general corporation statute by out-of-state incorporation.

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69. The case continued for so long that by the time Western petitioned the California Supreme Court for hearing, attorney general Mosk had become Justice Mosk of the California Supreme Court and had to recuse himself from participation in Western's petition. Id. at 252, 66 Cal. Rptr. at 316.

70. Professor Jennings's views on the case were already on record, see supra note 66. Commissioner Sobieski's views were the same, see Sobieski, In Support of Cumulative Voting, 15 Bus. Law. 316 (1960).


72. Western Air Lines, 258 Cal. App. 2d at 226, 66 Cal. Rptr. at 299.

73. Id. at 252, 66 Cal. Rptr. at 316.
It is not generally recognized that Western eventually emerged the victor in this protracted battle, which ran over a period of more than twelve years. The Western charter was amended following the first superior court decision in 1958, and all elections of directors were held on the basis of straight voting until the final court of appeal decision in 1968.74 The two dissident directors left the board in 1959.75 In 1968, the California legislature passed amendments which removed the jurisdiction of the commissioner over reorganizations of companies such as Western which were listed on the New York Stock Exchange.76

CONSTITUTIONAL RESTRICTIONS ON APPLYING FORUM LAW TO FOREIGN CORPORATIONS

The constitutional limitations on application of forum law to the internal affairs of a foreign corporation have never been very well explained. This is true whether the application is by way of conflict of laws principles or forum outreach statutes, either of the general corporation law or blue sky variety.77 In fact, the same observation may be made as to the application of constitutional principles to choice of forum law in a conflict of laws setting generally.78 If the best case for the constitutional underpinning of the internal affairs doctrine as a single law rule was made in McDermott Inc. v. Lewis,79 as one would have thought given Delaware’s interest in the subject, that case is not very compelling.

Writing in 1958, Reese and Kaufman found the subject “almost entirely unexplored”80 and freely recognized that their conclusions were “surmise and

74. Id. at 216, 66 Cal. Rptr. at 318.
77. The U.S. Supreme Court upheld the state blue sky statutes against due process, equal protection, and commerce clause challenges in Hall v. Geiger-Jones Co., 242 U.S. 539 (1917), Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917), and Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917). See also North Star Int’l v. Arizona Corp. Comm’n, 720 F.2d 578 (9th Cir. 1983); Carney v. Hanson Oil Co., 690 S.W.2d 404 (Mo. 1984). The statutes were insulated against direct supremacy clause attack by reference in the Securities Act of 1933, 15 U.S.C. § 77r (1982). The reach of the blue sky laws is much greater than the state corporation laws, finding application where a single existing stockholder is located in the forum state, even fortuitously. Therefore, the potential for mischief in this area is more severe. See Loss, The Conflict of Laws and the Blue Sky Laws, 71 Harv. L. Rev. 209 (1957).
79. 531 A.2d 206 (Del. 1987).
80. Reese & Kaufman, supra note 63, at 1118. In 1955, Latty had found no constitutional obstacle under the due process, full faith and credit or contract clauses to applying selected features
They left to one side the problem of the tramp corporation with no significant out-of-state contacts and gave their attention to corporations having substantial operations in more than one state. For a governing constitutional clause, they chose the full faith and credit clause, while recognizing the due process clause as a possibility and the commerce clause as an even less likely possibility. They recommended that for reasons of "predictability and ease of application" the law of the state of incorporation should be applied to internal affairs.

In 1971, Horowitz chose the commerce clause in preference to the full faith and credit clause as a justification for the single-law principle in corporate internal affairs, but he stressed that by no means does the principle require application of the law of the state of incorporation rather than forum law to such situations.

In a major study in 1985, Kozyris concluded that the commerce clause had superseded the due process and full faith and credit clauses as the primary focus for constitutional inquiry. He concluded that a state may apply its entire law to corporations incorporated in that state and to corporations, particularly pseudo-foreign ones, having predominant local contacts.

The analysis in *McDermott Inc. v. Lewis* sheds little light on the constitutional question. Curiously, the Delaware Supreme Court insisted that Delaware had no interest in the question of whether McDermott, a Delaware corporation, could vote the stock it held in its Panamanian parent, McDermott International, either for purposes of a "grouping of contacts" choice of law inquiry or for purposes of justifying application of Delaware law against a commerce clause attack. This ignores the fact that Delaware law presumptively governs the duty of McDermott International as a controlling stockholder of a Delaware corporation towards the minority stockholders-plaintiffs and the of local corporation law to pseudo-foreign "tramp" corporations.


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81. Reese & Kaufman, supra note 63, at 1145.
82. Id. at 1118.
83. Id. at 1129.
84. Id. at 1144. These are the same virtues attributed to the doctrine by the U.S. Supreme Court in the past. See, e.g., *First Nat’l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611, 621 (1983) ("certainty and predictability of result" while protecting "justified expectations"); *Shaffer v. Heitner*, 433 U.S. 186, 215 n.44 (1977) ("uniform and certain standard").
86. Kozyris, supra note 26, at 33-46.
87. Id. at 96. Kozyris was more critical of outreach statutes but still concluded that a state may regulate pseudo-foreign corporations and foreign corporations.
88. 531 A.2d 206 (Del. 1987).
89. Id. at 214 n.6.
90. Id. at 218-19.
The Internal Affairs Doctrine

It also ignores the fact that the principal offices of both McDermott and McDermott International were located in New Orleans, Louisiana, and that the law of Louisiana, like the law of Delaware and every other state in the United States, prohibited a controlled subsidiary from voting stock in its parent. The interests of Louisiana could therefore have been joined with the interests of Delaware as a single state for purposes of a “grouping of contacts” analysis.

The due process analysis in McDermott is unsupported by any authority, and the full faith and credit analysis is obiter dictum. The holding, therefore, rests on the commerce clause analysis, but the reasoning is not persuasive. The court begins with the MITE/CTS dictum quoted above, without acknowledging that the interstate commerce to which the Supreme Court was referring was the interstate commerce in the purchase and sale of corporate securities, not the interstate commerce in which the corporate issuer is engaged.

The Supreme Court’s ipse dixit in MITE/CTS cannot be taken out of context, and it is not convincing even in context. The statement in CTS that the “free market system” for trading corporate securities “depends at its core” upon the internal affairs doctrine is not true. The securities markets in this country depend at their core upon a complex regulatory scheme that is dominantly federal, beginning with the statutes administered by the Securities and Exchange Commission. They also depend upon the blue sky laws of all of the interested states. Finally, with respect to corporate governance and the market for corporate control, they depend upon the corporation laws of all the states in which the corporation transacts an intrastate business.

91. Yet the court stated that the plaintiffs had conceded that McDermott’s internal affairs were not involved in the case. Id. at 209.
92. Id.
93. Id. at 212.
94. Restatement (Second) of Conflict of Laws § 302, comment k (1971).
95. 531 A.2d at 218.
96. Id. at 219 n.16. If the due process and full faith and credit clauses can survive a choice-of-law decision by the Minnesota Supreme Court applying Minnesota law to obligations of an insurance company under automobile insurance policies written on automobiles garaged in Wisconsin and owned by a Wisconsin resident, where the accident involved occurred in Wisconsin with another Wisconsin vehicle, they can survive a great deal. See Allstate Ins. Co. v. Hague, 449 U.S. 302 (1981). See also Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 818 (1985).
97. See supra text accompanying notes 1 & 6.
100. Loss, supra note 77. See also Ad Hoc Subcommittee on Merit Regulation of the State Regulation of Securities Committee, Report on State Merit Regulation of Securities Offerings, 41 Bus. Law. 785 (1986).
Even leaving aside the special case of regulated industries such as banking and insurance, corporate governance of the national corporations in this country is regulated by countless laws, agreements, and regulations, including those of the national securities exchanges. For example, the New York Stock Exchange requires a majority of disinterested directors on the mandatory audit committee of the board and shareholder approval of certain stock issuances;\(^{101}\) the Internal Revenue Code provides for non-deductibility of certain golden parachute payments;\(^ {102}\) and the federal antitrust laws require pre-acquisition notification to the Federal Trade Commission and U.S. Department of Justice.\(^ {103}\)

Apart from the \textit{MITE/CTS} dictum, the \textit{McDermott} decision then rests on the authority of several cases holding that duplicative state governance of stock issuance by interstate corporations violates the commerce clause.\(^ {104}\)

In the past, some authorities have suggested that a state might properly impose its ideas about corporate governance on foreign corporations seeking to do an intrastate business by requiring them to reincorporate domestically.\(^ {105}\) Early notions of territoriality had led to the concept of multiple incorporation of a single business, creating multiple corporations with a unitary capital stock regarded as domestic in each state of incorporation and foreign in all others.\(^ {106}\) With respect to the \textit{MITE/CTS} rubric, such corporations might be regarded as domestic only to the state of first incorporation, but suggesting such an extension of the rule points up the rule's artificiality. It is also no answer to say that a corporation can escape the \textit{MITE/CTS} rule by reincorporating in a jurisdiction with a desired takeover statute; the issue is why it should have to, on the one hand, and why the host state needs the corporation's consent, on the other.

\(^{101}\) \textit{Non-U.S. Companies, N.Y.S.E. Guide} (CCH) ¶ 2505, at 4228 (1988). 


\(^{105}\) Railway Express Agency v. Virginia, 282 U.S. 440 (1931); Kaplan, \textit{supra} note 80, at 444–45; Kozyris, \textit{supra} note 26, at 61–62.

The easy acceptance of the state-of-incorporation primacy rule suggested in *MITE/CTS* by the few cases to date and some commentators\(^\text{107}\) needs to be reconsidered. It is not supported by the historical development of the internal affairs doctrine as buttressed by a commerce clause need for a single-law rule, as in the case of voting rights of corporate stock.\(^\text{108}\) Given that a single-law rule is constitutionally required, a state's status as state of incorporation may be presumptive evidence of primacy only because of the convenience and historical legitimacy of having such a rule and not because no other state could possibly have a superior claim to primacy. Moreover, there should be an actual danger of inconsistent regulation. If the risk of inconsistent regulation were sufficient, as stated in the *Telex* case,\(^\text{109}\) then the existing state blue sky law apparatus would have to be dismantled for fear of a potential conflict.

It remains to be decided what kind of considerations should lead to choosing a state other than the state of incorporation as having a superior claim to internal affairs governance. So far, no commentator or court has suggested that the state of domicile of a tramp corporation cannot regulate its internal affairs. However, with respect to takeover statutes, the target corporation is not likely to have all of its assets and business in a state other than the state of its incorporation.\(^\text{110}\)

In 1961, New York introduced the concept of "domiciled foreign corporation" into its Business Corporation Law, effective April 1, 1963, but promptly deleted it the following year.\(^\text{111}\) A "domiciled foreign corporation" could be defined as any one of the following: a foreign corporation (i) having at least two-thirds of its voting shares owned by New York residents; or (ii) having at least two-thirds of its outstanding capital stock, voting and nonvoting, owned by New York residents.

\(^{107}\) *Supra* notes 8-11 and accompanying text.


\(^{110}\) Compare the cases under 15 U.S.C. § 77c (1982) as to what constitutes a local business entitled to the intrastate offering exemption from registration under the Securities Act of 1933. The SEC has promulgated rule 147, 17 C.F.R. § 230.147, which requires, in addition to local incorporation and intrastate use of at least 80% of the net proceeds of the issue, that the issuer have its principal office within the state and that (i) at least 80% of the assets of the issuer and its consolidated subsidiaries come from operations within the state and (ii) at least 80% of the gross revenues of the issuer and its consolidated subsidiaries come from operations within the state. Compare the proposed, but not adopted, definition of "pseudo-foreign" corporation in North Carolina: "[A] foreign corporation ... which engages in no substantial business activity in the state of its incorporation, and which by virtue of the place and character of its business is more closely identified with the business life of North Carolina than with that of any other state." Latty, Powers & Breckenridge, *The Proposed North Carolina Business Corporation Act*, 33 N.C.L. Rev. 26, 52-53 (1954).

York residents; or (iii) having at least two-thirds of its business income or investment income allocable to New York for franchise tax purposes.\(^{112}\)

Existing New York law requires foreign corporations to comply with specified New York corporate law unless (i) shares of the corporation are listed on a national securities exchange or (ii) less than one-half of the business income of the corporation for the last three fiscal years (or since its incorporation, if less) was allocable to New York for franchise tax purposes.\(^{113}\)

As discussed above, California has a more complicated test for application of California corporate law to foreign corporations, requiring a majority of the stock, assets, sales, and payroll of the corporation to be within the state.\(^{114}\) Since our feelings of "corporateness" seem to be inextricably territorial, this is perhaps more appropriate, and it has so far withstood constitutional challenge. The statute cannot be avoided by incorporating a wholly owned subsidiary to conduct only intrastate California business, with control being exercised at the parent corporation level. The statute provides that in that situation, the parent corporation is also subject to California corporate law if it meets the majority of stock, assets, payroll, and sales test, taking the parent and all of its majority-owned subsidiaries as a consolidated unit. This is true even though the parent conducts no intrastate business in California and is therefore not qualified as a foreign business in that state.

Again, both the New York and California formulations specifically exclude many if not most of the publicly-held corporations which are interested in internal affairs governance. Presumably, this exclusion is mainly in response to the political realities of inducing major national corporations to continue substantial operations in the state.

It would also be possible to adopt a corporate domicile rule similar to the one enacted by Congress to determine citizenship of a corporation for purposes of federal court diversity jurisdiction and thus to consider a corporation a citizen of its state of incorporation and of the state of its principal place of business.\(^{115}\) This has some appeal since a corporation is identified to a considerable extent with its principal place of business. An existing body of decisional law exists to explain where that is, but it does not explain why the state of principal place of business should have a preferred position.

The statutory definitions of a foreign corporation included as an issuing public corporation for purposes of existing state takeover statutes vary. However, none require an absolute majority of all local contacts.\(^{116}\) All are similar to the Indiana definition upheld by the Supreme Court in \textit{CTS}, although that


\(^{113}\) N.Y. Bus. Corp. Law § 1320 (McKinney 1986).


\(^{115}\) 28 U.S.C. § 1332(c) (1982).

\(^{116}\) \textit{See supra} note 8 (statutory citations).
definition applies only to Indiana domestic corporations. The Indiana statute required (i) 100 or more shareholders; (ii) principal place of business, principal office, or substantial assets in Indiana; and (iii) either ten percent of the outstanding shares or ten percent of the shareholders or 10,000 shareholders resident in Indiana. The various requirements for covered foreign corporations can be roughly summarized as follows:

**ARIZONA**
Principal office or business, $1 million assets, and 500 employees.

**FLORIDA**
Principal office or business or substantial assets, 500 employees, $5 million annual payroll, and ten percent of shares or shareholders or 1,000 shareholders.

**KANSAS**
Principal business and substantial assets.

**MASSACHUSETTS**
Principal office, more assets or employees (including majority-owned subsidiary employees) than in other states, and ten percent shares or shareholders.

**NORTH CAROLINA**
Principal business, forty percent of domestic fixed assets, forty percent of domestic employees, and ten percent of shares or shareholders.

**OHIO**
Principal office or business, $5 million assets, $1 million annual state taxes, owns or leases in-state real estate, and ten percent shareholders and 1,000 shareholders, and 500 employees.

**WASHINGTON**
Principal office, majority of tangible assets, more taxable property than in other states, majority of employees (including subsidiary employees), 20,000 employees, ten percent of shares or shareholders or 5,000 shareholders.

The above tests for choice of law and constitutional purposes should be evaluated with the reminder that contacts are significant in this context only if they are rationally related to the purposes of the relevant statute. At one time, California required cumulative voting in the election of directors of all foreign corporations that held stockholders' meetings in California. The statute seems silly now because it can be avoided by holding meetings out of state. However, a more serious objection is that merely holding stockholders' meetings in California is not rationally related to the purposes of the statute, which is presumably the protection of minority shareholders.

The presence of in-state shareholders is as good a reason for state protection when they are solicited to sell a security as it is considered a reason for state blue sky protection when they purchased the shares in the first place. This is especially so since their choice in the case of a purchase is voluntary. Their choice in the case of a sale is not wholly voluntary, since they may be forced to sell in the case of a second-step freeze-out merger. However, the Supreme Court in the MITE case made it clear that the interest in the welfare of local shareholders may not be used as a device for interfering with the purchase of shares of shareholders resident in other states. Presumably, a law restricted to purchase of local shares would be valid, but the only result would be to bar local shareholders from participating in a tender offer which is typically made at a substantial premium over current market price.

In CTS, the Supreme Court stated that Indiana’s legitimate interest in regulating the affairs of domestic corporations was buttressed by the requirement that the corporations must have substantial resident shareholders to come within the purview of the statute. This should not be taken to mean that a small state such as Delaware cannot enact takeover statutes for domestic corporations without requiring significant in-state shareholders, and the Delaware statute has fared well in the courts so far. In the nature of things, it is impossible for Delaware to have any more than an insignificant number of resident shareholders in national companies, and this should not make a difference.

On the other hand, what is the significance of the fact that populous states can muster ten percent or more of the stockholders, in either number or interest, of a national corporation? If one ignores brokerage and nominee holdings, which some statutes do, or uses the alternative tests of 1,000 or even 10,000 shareholders, it becomes clear that this is too small a number of shares to be used as a lever to control the tender offer for the rest of the shareholders. If a state has more than a majority of stockholders in interest, that is significant. If a state has more stockholders in interest than any other state, that perhaps is significant. In either case, however, this factor can change from day to day given the nature of the national market for securities, and this has been a criticism of the California statute that regulates foreign corporations based on local stockholdings.

On balance, since the purpose of the statute is to regulate the offer to all of the shareholders, the presence in state of less than a majority, or at a minimum a plurality, should be considered a minor factor.

120. 107 S. Ct. at 1652.
122. See articles cited supra note 63.
PRESENCE OF PRINCIPAL EXECUTIVE OFFICE OR PRINCIPAL BUSINESS OR ASSETS IN STATE

The presence of other factors is significant, particularly in light of the justified criticism that regarding takeover statutes as inspired by thoughts of shareholder protection is naive. The presence of the principal executive offices is important since that is ordinarily where the directors and officers of the company make the decisions which affect the company's welfare. However, the location of this office in the case of a national company may be determined more often than not by proximity to the residence of the chief executive officer, and management can change it at will. The presence of the principal place of business is less problematic, but this is usually dictated by the labor market and proximity to suppliers and customers, always allowing for historical factors and the costs in terms of dollars, employee morale, and customer good will of changes in plant location or distribution methods. The same observations can be made for the location of real or personal property and employees. The location of less than a majority, or at least a plurality, of these factors, cannot be significant in the context at issue.

Using the above weighting of factors, the Washington statute appears justified from a constitutional point of view. In fact, the requirements of the statute are so severe that only one company, the Boeing Company, can meet them. Boeing has long been identified with the State of Washington, as witness the fact that its principal office and a majority of its tangible assets and employees are located there. This certainly gives Boeing a local presence that makes the choice of Delaware as state of incorporation seem less important by comparison. This is not the place to revive the debate over the reasons for the choice of Delaware as state of incorporation by a majority of Fortune 500 and New York Stock Exchange listed companies, but it should be evident by now that the choice is dictated by the perceived superiority of Delaware corporate law in terms of stability and flexibility for management.

The Massachusetts and North Carolina statutes are also possible candidates for approval since they require the principal office or business and an apparent plurality of assets and/or employees to be in state. The in-state presence of the principal operations of the corporation, particularly over a period of time, cannot be regarded as accidental or insignificant. However, the location of a bare plurality of assets alone may change from month to month in any particular company for reasons having nothing to do with corporate governance.


The other statutes do not have the same conviction to them. While all require significant in-state contacts, these contacts might be sufficient to require in-state incorporation for local operations but not to subject out-of-state operations and shareholders to local control.

It has frequently been argued that applying state law other than the law of the state of incorporation to internal corporate affairs creates a situation of intolerable uncertainty for corporate planners and invites chaos. The uncertainty and potential chaos are ascribed to the difficulty of policing or even determining the location of the principal place of business or the majority of stockholders at any particular point in time and the fact that the corporation's internal affairs may be subject to a different controlling law from year to year due to factors beyond the control of management. This argument is overstated. As has already been set out in detail, national corporations have successfully dealt with conflicting regulation for many years. Corporate counsel are quite accustomed to planning in the face of cumulative and sometimes conflicting laws at the federal, state, local, and foreign levels.

As Professor Buxbaum has pointed out, most interstate conflicts are of either the nuisance or the "two hurdle" (i.e., one standard is higher than the other) variety; seldom does a true "conflict of obeisance" arise, with one state prohibiting what another interested state commands. In any event, it is hardly imaginable that a corporation could accidentally meet the stringent standards of the New York or California tests cited above, since those require a majority of the corporation's business to be allocated to the home state. The major objection, therefore, seems to be that a corporation might fail the host state test for reasons beyond its control, i.e., the removal of a majority of non-nominee stockholders from the state in the case of California. This objection can be met in any of several ways: (i) incorporation of the business in California; (ii) location of a majority of the company's assets, sales, and payroll outside California in order to escape the statute regardless of the location of stockholders; or (iii) amendment of the statute to eliminate the majority of stockholder requirement.

127. Kaplan observed in 1968:

The precise details of such confusion are seldom stated, other than to assert that it would be impossible to comply with mutually exclusive requirements. Such a result would almost never occur under present corporation statutes and is unlikely to occur in the future. This argument of uncertainty and confusion is seldom challenged, though it is probably neither so cogent nor so compelling as it might at first seem.

129. See supra notes 113-14 and accompanying text.
CONCLUSION

The MITE/CTS proposal that the state of incorporation have exclusive rights in the field of internal affairs was not necessary to the decisions in those cases and should not be blindly adopted, whether in the area of takeover statutes or any other internal affairs issue. While the state of incorporation has historically been recognized as having the authority to regulate domestic corporations, this right was never exclusive. Other states have interests due to the presence of local assets, shareholders, creditors, suppliers, customers, corporate principal place of business, and other considerations which may outweigh the interest of a state of incorporation; Delaware is the principal example of such a state of incorporation since it frequently has none of those interests. To say that a state may not regulate foreign corporations having a predominance of local contacts is to create a constitutional right in a foreign corporation to establish its principal operations in a host state free from local control. This would certainly stand all existing precedent in this area on its head.