THE CONSTITUTIONALITY OF OUTREACH STATUTES UNDER THE DORMANT COMMERCE CLAUSE

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This Comment argues that the Commerce Clause of the U.S. Constitution[1] does not always restrain a state from imposing its corporate internal-affairs[2] law on corporations from other jurisdictions. Recognizing that the Constitution correctly restrains many forms of legislative meddling, this Comment concludes that some regulation is nonetheless constitutional. The argument is presented in the context of two legal extremes: Delaware law, which finds such regulation unconstitutional *per se*,[3] and California law, which contains statutes that regulate the internal affairs of out-of-state corporations doing most of their business in California.[4]

When a controversy implicating a corporation's internal affairs arises, courts must decide which jurisdiction's corporate code to apply. Under the common law, courts usually choose the law of the jurisdiction of incorporation.[5] This choice-of-law principle is called the "internal affairs" doctrine.[6] Applying the doctrine hypothetically, a

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[1] U.S. CONST. art. I, § 8, cl. 3.

[2] "Internal affairs" include, at minimum, the relations between a corporation's shareholders, officers, directors, and the corporation itself. McDermott, Inc. v. Lewis, 531 A.2d 206, 215 (Del. 1987); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 313 cmt. a (1971). Shareholder voting disputes and directors' standard of care are typical internal-affairs issues.

[3] *See* VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1116 (Del. 2005).

[4] CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006)

[5] First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba, 462 U.S. 611, 621 (1983) (dictum). *But see* Beloit Liquidating Trust v. Grade, 2004 WI 39, ¶ 23, 270 Wis. 2d 356, ¶ 23, 677 N.W.2d 298, 306–07 ("Given this clear statutory language, and Wisconsin's failure to adopt the internal affairs doctrine, either by statute or through case law, we conclude that . . . Wisconsin law should be applied in determining whether the directors or offices [sic] breached their fiduciary duty . . . .").

[6] Edgar v. MITE Corp., 457 U.S. 624, 645 (1982) (dictum). In *Edgar*, the court stated:

New Jersey corporation should always expect New Jersey law to govern its internal-affairs disputes, no matter which jurisdiction adjudicates the dispute.

Some states have carved out exceptions to the internal affairs doctrine,[7] the most important being "outreach statutes."[8] Under certain conditions, outreach statutes provide that forum law applies to a foreign corporation's internal affairs (a "foreign corporation" is one that is not incorporated within the forum state; the term does not necessarily mean a corporation from another country).[9] Such statutes can augment, or even override, the law of the jurisdiction of incorporation.[10]

By subjecting corporations' internal affairs to an additional legislative regime, outreach statutes challenge the internal affairs doctrine's central premise—that only one law should govern the internal affairs of a corporation.[11] Such a fundamental tension will resolve only if 1) the internal affairs doctrine evolves to accommodate out-

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> 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.

Id. (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. b (1971)).

[7] Terence L. Blackburn, *The Unification of Corporate Laws: The United States, the European Community and the Race to Laxity*, 3 GEO. MASON L. REV. 1, 56 (1994).

[8] *See, e.g.*, CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006) (setting forth conditions under which foreign corporations are subject to California laws that regulate, among other things, election and removal of directors, directors' standard of care, liability of directors for unlawful distributions, shareholders' right to cumulative voting, limitations on mergers, and limitations on sale of assets); CAL. CORP. CODE § 1602 (West 1990); N.Y. BUS. CORP. LAW §§ 1315–1320 (Consol. 1983 & Supp. 2005) (applying New York law to foreign corporations regarding issues of production of shareholder lists, director liability, and reorganizations); *see also, e.g.*, Havlicek v. Coast-to-Coast Analytical Servs. Inc., 46 Cal. Rptr. 2d 696, 700 (Cal. Ct. App. 1995) (construing section 1602 to apply to foreign corporations regardless of the applicability of section 2115); N. Am. Asbestos Corp. v. Superior Court, 225 Cal. Rptr. 877, 882–83 (Cal. Ct. App. 1986) ("There are a myriad of statutory provisions that apply to foreign corporations that are not included in section 2115 . . . . [T]hese statutory provisions . . . apply to all foreign corporations, not just to corporations which meet the percentage figures prescribed in section 2115.").

[9] *E.g.*, WIS. STAT. ANN. § 180.1704 (West 2002) ("[T]his chapter applies to all foreign corporations transacting business in this state . . . ."); *see* Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, LAW & CONTEMP. PROBS., Summer 1985, at 161, 162.

[10] *See, e.g.*, CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006).

[11] *See generally* Grosset v. Wenaas, 35 Cal. Rptr. 3d 58 (Cal. Ct. App. 2005), *cert. granted sub nom., depublished by* Grosset v. Wenaas (Huang), 127 P.3d 27 (Cal. 2006); VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 (Del. 2005).

reach statutes; or 2) all outreach statutes are repealed. Some states have embraced outreach statutes, finding that they supplement the basic rule of the internal affairs doctrine.[12] Others, most notably Delaware, have categorically rejected them.

Delaware's strongest argument for universally invalidating outreach statutes is that the Commerce Clause of the U.S. Constitution[13] restrains state legislatures from enacting them.[14] The corollary of this argument is that the Commerce Clause mandates the strict application of the internal affairs doctrine. Facially, the Commerce Clause simply grants Congress the positive power to regulate interstate commerce.[15] But it is beyond question that it also has a dormant (or negative) power that continuously restrains states from passing laws unduly burdensome to interstate commerce.[16] Some argue that outreach statutes, by undermining the simplicity and efficiency of the internal affairs doctrine, are unduly burdensome to interstate commerce and therefore violate the dormant Commerce Clause.[17]

Although this issue has yet to reach the Supreme Court of the United States, state legislatures and courts have been reacting for decades. On the legislative front, California enacted section 2115 of the California Corporations Code,[18] an outreach statute seemingly tailored to survive dormant-Commerce-Clause scrutiny.[19] Section 2115 contains extensive jurisdictional hooks that drastically limit the number of occasions where it applies, thus reducing its burden on interstate commerce.[20]

On the litigation front, the California Supreme Court has long since upheld the validity of section 2115 under the dormant Com-

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[12] *E.g.*, Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 861 (Cal. Ct. App. 1982) (California).

[13] U.S. CONST. art. I, § 8, cl. 3.

[14] *See VantagePoint*, 871 A.2d at 1115, 1116 ("The 'internal affairs doctrine is a major tenet of Delaware corporation law having important federal constitutional underpinnings.'" (quoting McDermott, Inc. v. Lewis, 531 A.2d 206, 209 (Del. 1987))).

[15] U.S. CONST. art. I, § 8, cl. 3; Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 6 (1824).

[16] *See, e.g.*, Fulton Corp. v. Faulkner, 516 U.S. 325, 330 (1996); Associated Indus. of Mo. v. Lohman, 511 U.S. 641, 646–47 (1994); Cooley v. Bd. of Wardens, 53 U.S. (12 How.) 299 (1851); *Gibbons*, 22 U.S. at 6. For the tests to determine whether a regulation is unduly burdensome, see *infra* Part III.

[17] *See VantagePoint*, 871 A.2d at 1115.

[18] CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006).

[19] *See* John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 57 (1985) ("The California approach represents the most serious current challenge to [the internal affairs doctrine] . . . .").

[20] *See infra* notes 70–72. *But cf.* N.Y. BUS. CORP. LAW §§ 1315–1320 (Consol. 1983 & Supp. 2005) (applying to all corporations doing business in New York).

merce Clause.[21] But recently the Delaware Supreme Court, in *VantagePoint Venture Partners 1996 v. Examen, Inc.*,[22] came out against outreach statutes, declining to apply section 2115 to a shareholder voting dispute.[23] The court held that the dormant Commerce Clause mandates the constant, universal application of the traditional internal affairs doctrine, to the exclusion of the California statute.[24]

This Comment argues that *VantagePoint*'s state- and constitutional-law analyses are misleading and should not influence legal trends regarding the relationship between the dormant Commerce Clause and the way courts choose an internal affairs regime.[25] It concludes that Supreme Court of the United States precedent does not support a constitutionally mandated internal affairs doctrine. It also concludes that outreach statutes that are narrow in scope are constitutionally permissible.

Part I discusses the internal affairs doctrine's historical development and how it became the predominant method of choosing internal corporate affairs law. It then discusses the doctrine's modern articulation and justifications. Part II introduces outreach statutes and examines the mechanics of section 2115 of the California Corporations Code. Part III summarizes the Supreme Court's current approach to dormant-Commerce-Clause analysis, argues that the dormant Commerce Clause does not mandate the application of the internal affairs doctrine, and demonstrates why section 2115 is permissible under the dormant Commerce Clause. It also argues that the *VantagePoint* court incorrectly applied Supreme Court precedent to hold that the dormant Commerce Clause mandates the internal affairs doctrine. Part IV concludes that narrowly drafted outreach statutes are a permissible alternative to the internal affairs doctrine.

[21] Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 861 (Cal. Ct. App. 1982) ("We conclude that to the extent that the cumulative voting requirement imposed by section 2115 upon pseudo-foreign corporations is shown to have any effect upon interstate commerce, the effect is incidental, and minimal in relation to the purpose which that requirement is designed to achieve."). California defines a pseudo-foreign corporation to be "one with its technical domicile outside of [the] state but one which exercises most of its corporate vitality within [the state]." W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 727 (Cal. Ct. App. 1961).

[22] 871 A.2d 1108 (Del. 2005).

[23] *See id.* at 1116.

[24] *Id.*

[25] *See* discussion *infra* Parts II.C, III.C.1–2.

I. THE INTERNAL AFFAIRS DOCTRINE

Currently, the internal affairs doctrine enjoys canonical status as a principle of corporate law.[26] Despite isolated departures throughout legal history,[27] the "umbilical tie" of a corporation to its state of incorporation is generally regarded as determinative of the law to be applied to all intracorporate disputes.[28] This widespread acceptance is principally limited by the doctrine's inapplicability to situations involving third parties, that is, situations outside a corporation's internal affairs.[29] Nonetheless, the doctrine is generally unquestioned by modern corporate lawyers in most disputes involving internal affairs.[30]

A. A Brief Historical Overview

The doctrine's rise began in the nineteenth century. It was first articulated in 1868 by a New York appellate court,[31] but initially failed to gain traction in other jurisdictions.[32] In 1885, the Court of Appeals of Maryland, in *North State Copper & Gold Mining Co. v. Field*,[33] energized the doctrine by expressly adopting it,[34] and by the end of the century most states routinely applied it.[35] Isolated judicial departures

[26] *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987) (dictum) ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations . . . .").

[27] *See* W. Air Lines v. Sobieski, 12 Cal. Rptr. 719, 727–28 (Cal. Ct. App. 1961) (permitting regulation of internal affairs of a corporation having its technical domicile in another state but exercising most of its corporate vitality within California); *see also* Mansfield Hardwood Lumber Co. v. Johnson, 268 F.2d 317, 321 (5th Cir. 1959) ("[D]ecisions . . . [applying the internal affairs doctrine are] inapplicable or unsound where the only contact point with the incorporating state is the naked fact of incorporation, and where all [geographical] contact points . . . are found in another jurisdiction."); Toklan Royalty Corp. v. Tiffany, 141 P.2d 571, 573–74 (Okla. 1943) (applying Oklahoma law to Delaware corporation as to inspection of books).

[28] McDermott, Inc. v. Lewis, 531 A.2d 206, 216 (Del. 1987).

[29] *Id.*; *see also* First Nat'l City Bank v. Banco Para El Comercio Exterior De Cuba, 462 U.S. 611, 621–22 (1983) (dictum); State Farm Mut. Auto. Ins. v. Superior Court, 8 Cal. Rptr. 3d 56, 67 (Cal. Ct. App. 2003) (quoting *McDermott*, 531 A.2d at 216); *id.* at 67–68 (quoting *W. Air Lines*, 12 Cal. Rptr. at 726).

[30] Kozyris, *supra* note 19, at 19 ("[The internal affairs doctrine] is generally treated as axiomatic.").

[31] *See* Howell v. Chi. & N.W. Ry. Co., 51 Barb. 378, 383–84 (N.Y. App. Div. 1868).

[32] Joseph H. Sommer, *The Subsidiary: Doctrine Without a Cause?*, 59 FORDHAM L. REV. 227, 276 n.186 (1990).

[33] 20 A. 1039 (Md. 1885).

[34] *Id.* at 1040–41.

[35] *See* Sommer, *supra* note 32; *see also* Rogers v. Guar. Trust Co. of N.Y., 288 U.S. 123, 130 (1933) (dictum) (citing multiple cases to support the widespread acceptance of the internal affairs doctrine).

from the doctrine continued throughout the early twentieth century,[36] but they eventually disappeared as it became a routine part of corporate law.[37] Resulting from this widespread acceptance, there is no significant common-law competitor to the internal affairs doctrine. Modern questions as to its applicability arise almost exclusively in the context of a competing outreach statute.[38]

Despite the internal affairs doctrine's continued vitality, many of the conditions that led to its creation have faded or disappeared. The doctrine evolved during a relatively primitive stage of corporate law, where courts closely associated corporations, even private ones, with the governments of their originating states.[39] This perception, along with technological barriers, discouraged courts from meddling in the internal affairs of foreign corporations. Referencing principles of sovereignty, courts consistently noted the legal limits of their power over foreign corporations, and the special relationship that such corporations had with their jurisdiction of incorporation.[40] The internal affairs doctrine allowed these courts to avoid the murky problem of asserting judicial authority over these pseudo-sovereign entities.

This reluctance to meddle in the affairs of foreign corporations, in addition to supportive legal and technological innovations, facilitated a corporate charter competition, whereby states (through low taxes or efficient corporation codes) competed for the revenue that corporations bring to local markets.[41] With the general acceptance of the internal affairs doctrine, investors could now be sure that wherever they went, courts would respect their corporate form. Supporting this legal development was the repeal, starting in New Jersey, of statutes requiring domestic corporations to maintain a physical pres-

[36] *See* Sommer, *supra* note 32 (citing Travis v. Knox Terpazone Co., 109 N.E. 250, 251–52 (N.Y. 1915)).

[37] *But see* W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719 (Cal. Ct. App. 1961).

[38] *See, e.g.*, Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852 (Cal. Ct. App. 1982).

[39] *See* Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525, 561 (2005).

[40] *See* Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine* 35–37 (Emory Univ. Sch. of Law, Law and Econ. Research Paper Series, Paper No. 06-04, 2006), *available at* http://ssrn.com/abstract=686592. In 1874, Justice Bradley wrote:

> [I]t is commonly said that the State has absolute control over the corporations of its own creation, and may impose upon them such conditions as it pleases; and like control over its own territory, highways, and bridges . . . . [We must pursue our analysis in light of] the very plenary powers which a State has always been conceded to have over its own territory, its highways, its franchises, and its corporations . . . .

R.R. Co. v. Maryland, 88 U.S. (21 Wall.) 456, 472–73 (1875).

[41] Tung, *supra* note 39, at 544.

ence within the state.[42] By divorcing the corporation's physical reality from its jurisdiction of incorporation, states could now attract businesses, regardless of their geographical location. The result of these developments was that New Jersey, and then Delaware, became the home state of the majority of large, U.S. corporations.[43]

The charter competition's proponents and detractors continually engage in what has become a classic debate. Supporters of the competition have suggested that it maximizes value to shareholders.[44] Critics argue that the charter competition gives state legislatures an incentive to "race to the bottom" by enacting corporation codes skewed in favor of managerial interests.[45] Some have even suggested that a federal corporation code would be preferable to the current system.[46] Despite such criticisms, and increased federal regulation,[47] corporate law remains primarily a state affair.[48] So for now, the in-

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[42] *Id.*

[43] *See* Tung, *supra* note 40, at 3. Many corporations left New Jersey for Delaware after Governor Woodrow Wilson and the Progressive Party in the New Jersey legislature revised the corporation code. *See* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2390 (1998).

[44] *See, e.g.*, Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 919–20 (1982); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES L. 387, 504 (2001) ("[I]t is difficult to imagine any real-world political process that would do a better job at enhancing share value than the competitive process in which Delaware is the prominent incorporation state.").

[45] *See, e.g.*, Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1440–41 (1992) (arguing that state charter competition creates rules biased toward managerial interests); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 663–66 (1974) (arguing that state charter competition creates a race to the bottom).

[46] *E.g.*, Bebchuk, *supra* note 45, at 1437–42. Professor Bebchuk writes:

> This Article puts forward a new approach to the question of state charter competition. My analysis indicates that this competition works well in some areas of corporate law but poorly in others; that is, state competition produces a race for the top with respect to some corporate issues but a race for the bottom with respect to others. More importantly, my analysis identifies those issues with respect to which state competition is likely to produce undesirable rules. This analysis provides workable criteria that I use to delineate the desirable limits on state competition and advocate a significant expansion of federal corporate law.

Id at 1440.

[47] *E.g.*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2005) (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

[48] *See* Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1575 (2005) ("The Sarbanes-Oxley Act is, at most, a fairly narrow exception as it arguably alters the allocation of authority only in its audit committee provisions.").

ternal affairs doctrine remains the lynchpin of this controversial system.

B. The Modern Internal Affairs Doctrine

In *McDermott, Inc. v. Lewis*,[49] the Supreme Court of Delaware reaffirmed its commitment to the internal affairs doctrine by declining to apply Delaware law to a Panama corporation's internal affairs.[50] The relevant issue in *McDermott* was whether a ninety-two-percent-owned subsidiary of a Panamanian parent corporation could vote its ten-percent interest in the parent corporation's common stock.[51] The court noted that no United States jurisdiction permitted this voting practice, but Panama did.[52] The court applied Panama law to the dispute and allowed the voting practice, citing the internal affairs doctrine as being "well established" in Delaware.[53] The court summarized the doctrine: "The internal affairs doctrine requires that the law of the state of incorporation should determine issues relating to internal corporate affairs. Under Delaware conflict of laws principles and the United States Constitution, there are appropriate circumstances which mandate application of this doctrine."[54]

McDermott articulates three federal constitutional bases that mandate the internal affairs doctrine: the Full Faith and Credit Clause,[55] the Due Process Clause of the Fourteenth Amendment,[56] and the Commerce Clause.[57] Of the three principles, the dormant

[49] 531 A.2d 206 (Del. 1987).
[50] *Id.* at 208–09.
[51] *See id.*
[52] *Id.* at 212.
[53] *Id.* at 215.
[54] *Id.* (citation omitted).
[55] U.S. CONST. art. IV, § 1. *See, e.g.*, Broderick v. Rosner, 294 U.S. 629, 643 (1935) (applying the law of the state of incorporation pursuant to the Full Faith and Credit Clause); Converse v. Hamilton, 224 U.S. 243, 256–58 (1912) (allowing receiver to sue stockholders in a state other than the state of incorporation, and finding that a state must give full faith and credit to laws of the state of incorporation). *But see* Kozyris, *supra* note 19, at 31 (noting a countertrend beginning with *Alaska Packers Ass'n v. Industrial. Accident Commission*, 294 U.S. 532 (1935)).
[56] U.S. CONST. amend. XIV, § 1; VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1113 (Del. 2005); *see also* Kozyris, *supra* note 19, at 39 (noting that recent developments in the Supreme Court suggest that not applying the internal affairs doctrine may violate due process).
[57] U.S. CONST. art. I, § 8, cl. 3; *see also VantagePoint*, 871 A.2d at 1113 (explaining that the U.S. Constitution mandates the internal affairs doctrine partially because of the Commerce Clause).

Commerce Clause is the most important in this context.[58] Courts rarely refer to the Due Process Clause,[59] and they no longer rely on the Full Faith and Credit Clause at all.[60]

The dormant-Commerce-Clause basis for the internal affairs doctrine is the most powerful, because it plays upon the Supreme Court of the United States' sensitivity to the potential burdens of inconsistent regulation upon interstate commerce.[61] Indeed, the burden of inconsistent regulation occupied a significant portion of *McDermott*'s analysis.[62] Taken as a whole, *McDermott* suggests that virtual chaos is the sole alternative to the strict application of the internal affairs doctrine.

Despite *McDermott*'s analysis, the Supreme Court of the United States has never taken the position that the U.S. Constitution mandates the internal affairs doctrine. Indeed, the doctrine dominates the past and present of corporate law—courts rarely hesitate to apply it—but it evolved in an economic world very different from our own. And until the Supreme Court of the United States rules definitively upon the subject, states are free to contemplate alternative regimes (such as outreach statutes) to govern the internal affairs of foreign corporations.

II. OUTREACH STATUTES: SECTION 2115 AND *VANTAGEPOINT VENTURE PARTNERS 1996 V. EXAMEN*[63]

An outreach statute applies the substantive law of the forum state to a foreign corporation in certain limited circumstances.[64]

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[58] *See, e.g.*, CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987); Edgar v. MITE Corp., 457 U.S. 624 (1982). *See generally* Kozyris, *supra* note 19, at 35–46.

[59] *But cf. McDermott*, 531 A.2d at 216 ("[D]irectors and officers have a significant right, under the Fourteenth Amendment's due process clause, to know what law will be applied to their actions.").

[60] *See* Kozyris, *supra* note 19, at 31.

[61] The Supreme Court has often invalidated statutes for subjecting interstate commerce to inconsistent regulations. *E.g.*, Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 583–84 (1986); *Edgar*, 457 U.S. at 642–43 (plurality opinion); Kassel v. Consol. Freightways Corp. of Del., 450 U.S. 662, 671 (1981); S. Pac. Co. v. Ariz. *ex rel.* Sullivan, 325 U.S. 761, 774 (1945).

[62] *See McDermott*, 531 A.2d at 216 (Del. 1987) ("'[A]pplying local internal affairs law to a foreign corporation . . . 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 . . . .'" (quoting Kozyris, *supra* note 19, at 98)).

[63] 871 A.2d 1108 (Del. 2005).

[64] Christian Kersting, *Corporate Choice of Law—A Comparison of the United States and European Systems and a Proposal for a European Directive*, 28 BROOK. J. INT'L L. 1, 25 (2002); *see* discussion *supra* notes 8–10 and accompanying text.

Unlike the internal affairs doctrine, outreach statutes do not have a long history, and only California and New York have implemented explicit outreach provisions in their corporation codes.[65] New York's outreach statutes subject foreign corporations to forum law regarding, among other things, the right to inspect shareholder lists, the filing of a record of voting trusts, the liability of officers and directors, and the liability of corporations for failure to disclose certain information.[66] Section 2115 of the California Corporations Code[67] contains an even broader range of substantive provisions that are potentially applicable.[68]

But section 2115 is narrow in scope.[69] Section 2115 will apply to a foreign corporation only if: 1) the average of the corporation's property factor, [70] payroll factor,[71] and sales factor,[72] as defined by the

[65] DeMott, *supra* note 9, at 164; *see* CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006); N.Y. BUS. CORP. LAW §§ 1315–1320 (Consol. 1983 & Supp. 2005).

[66] DeMott, *supra* note 9, at 164–65 (citing N.Y. BUS. CORP. LAW §§ 1315–1320 (Consol. 1983 & Supp. 2005)).

[67] CAL. CORP. CODE § 2115.

[68] Once the code is found to apply, California law governs many issues involving directors, including the annual election of directors, the removal of directors without cause, the removal of directors by court proceedings, the filling of director vacancies where less than a majority in office was elected by shareholders, the directors' standard of care, the liability of directors for unlawful distributions, and the indemnification of directors, officers, and others. CAL. CORP. CODE § 2115(b). Additionally, California law governs limitations on corporate distributions in cash or property, the liability of shareholders who receive unlawful distributions, the requirement for an annual shareholders' meeting and the remedy if same is not timely held, the shareholder's right to cumulate votes at any election of directors, and the supermajority vote requirement. *Id.* Finally, the code imposes limitations on sales of assets, mergers, and conversions; dictates the requirements of conversions; and governs reorganizations, dissenter's rights, content of records and reports, actions by an attorney general, and the rights of inspection. *Id.*

[69] *Compare* CAL. CORP. CODE §§ 2115(a), (c) (West Supp. 2006) (restricting section's applicability to close corporations having predominant contacts with California), *with* N.Y. BUS. CORP. LAW § 1317 (Consol. 1983 & Supp. 2005) (applying director liability provisions to any foreign corporation doing business in New York).

[70] The California Revenue and Taxation Code calculates the property factor in the following manner:

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

CAL. REV. & TAX CODE § 25129 (West 1990).

[71] The California Revenue and Taxation Code calculates the payroll factor in the following manner: "The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the taxable year by the taxpayer for compensa-

California Revenue and Taxation Code,[73] is greater than fifty percent; and 2) more than one-half of its voting securities are held by persons listed in the latest meeting of shareholders as having California addresses.[74] Publicly traded corporations are completely excluded from its reach.[75] Once triggered, section 2115 provides that most aspects of California corporate law apply to the internal affairs of foreign corporations.[76]

In *VantagePoint Venture Partners 1996 v. Examen, Inc.*,[77] the Delaware Supreme Court considered and rejected applying section 2115. *VantagePoint* was a dispute over a merger involving Examen, Inc. ("Examen"), a Delaware corporation of which VantagePoint Venture Partners 1996, Inc. ("VantagePoint") owned a majority of Series A Preferred Stock but no common stock.[78] VantagePoint opposed the merger, but a majority of Examen's shareholders approved it in a cumulative vote pursuant to Delaware law.[79] Had California law applied, VantagePoint would have been able to vote its shares as a separate class,[80] effectively giving it a veto over the merger. VantagePoint asserted that section 2115 of the California Corporations Code should have displaced Delaware law and required class voting.[81]

Rejecting the application of section 2115, the court reaffirmed *McDermott*'s articulation of the internal affairs doctrine.[82] However, the true significance of the case was that it held that the Federal Constitution mandates the application of the internal affairs doctrine;[83] in this case, against the backdrop of a competing outreach statute. So for the first time, albeit indirectly, a case has placed the basic constitutionality of outreach statutes at issue, and a court has categorically

tion, and the denominator of which is the total compensation paid everywhere during the taxable year." *Id.* § 25132.

[72] The California Revenue and Taxation Code calculates the sales factor in the following manner: "The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year." *Id.* § 25134.

[73] *Id.*

[74] CAL. CORP. CODE § 2115(a)(2) (West 1990 & Supp. 2006).

[75] *Id.* § 2115(c).

[76] *See id.* § 2115(a)(2).

[77] 871 A.2d 1108 (Del. 2005).

[78] *Id.* at 1111.

[79] *See id.* at 1110–11.

[80] *Id.* at 1111.

[81] *See id.* at 1109–12.

[82] *See id.* at 1114, 1116; *see supra* text accompanying note 54.

[83] *VantagePoint*, 871 A.2d at 1116.

rejected their applicability. The influence of this case has been felt even in California, where recently a state appellate court extensively quoted *VantagePoint* for its endorsement of the internal affairs doctrine,[84] its identification of the doctrine's "constitutional underpinnings,"[85] and its critical analysis of section 2115.[86]

III. THE DORMANT COMMERCE CLAUSE, THE INTERNAL AFFAIRS DOCTRINE, AND SECTION 2115

The Commerce Clause grants Congress the positive power to regulate interstate commerce.[87] It also operates negatively, as a restraint on state regulation.[88] This restraint is a principle known as the dormant Commerce Clause.[89] The U.S. Supreme Court decides when to invoke this restraint mostly by using a test articulated in *Pike v. Bruce Church, Inc.*.[90] Over time, the Court has refined the doctrine and identified certain types of regulations that are especially likely to fail dormant-Commerce-Clause scrutiny.

A. The Dormant Commerce Clause

Absent federal legislation states may freely regulate commerce, so long as they act within the bounds of the dormant Commerce Clause.[91] The Supreme Court of the United States has articulated several distinct tests for determining these bounds.[92] The older tests define bright-line categories of permissible and impermissible regula-

[84] Grosset v. Wenaas, 35 Cal. Rptr. 3d 58, 69 (Cal. Ct. App. 2005), *cert. granted sub nom., depublished by* Grosset v. Wenaas (Huang), 127 P.3d 27 (Cal. 2006) (quoting *VantagePoint*, 871 A.2d at 1113).

[85] *Id.* at 66, 68–69 (quoting *VantagePoint*, 871 A.2d at 1113–16).

[86] *Id.* at 68 (quoting *VantagePoint*, 871 A.2d at 1113–16).

[87] U.S. CONST. art. I, § 8, cl. 3; Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 6 (1824).

[88] *See, e.g.*, Fulton Corp. v. Faulkner, 516 U.S. 325, 330 (1996); Associated Indus. of Mo. v. Lohman, 511 U.S. 641, 646–47 (1994); Cooley v. Bd. of Wardens, 53 U.S. (12 How.) 299, 317 (1851); *Gibbons*, 22 U.S. at 6.

[89] *See* ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 401 (2d ed. 2002).

[90] 397 U.S. 137 (1970).

[91] *See* City of Phila. v. New Jersey, 437 U.S. 617, 623 (1978) (citing Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 440 (1977)).

[92] *See* Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970); DiSanto v. Pennsylvania, 273 U.S. 34, 37 (1927) ("A state statute which by its necessary operation directly interferes with or burdens foreign commerce is a prohibited regulation and invalid . . . ."); *Cooley*, 53 U.S. (12 How.) at 319 (prohibiting state regulation of national subject matter requiring uniform regulation but allowing state regulation of local subject matter requiring diverse regulation); *Gibbons*, 22 U.S. (9 Wheat.) at 199–200, 203 (permitting laws adopted under the police power versus laws regulating commerce among the states).

tions.[93] Generally, the Court has abandoned these rigid rules.[94] The modern approach combines a threshold criterion with a balancing test.[95] Furthermore, some regulations so affect the balancing test, they function like threshold criteria.[96] Regardless of the approach, the Court will look to the underlying policies of the dormant Commerce Clause to guide its application.[97]

These policies are rooted in history, economics, and politics.[98] Justice Brennan concisely captured the historical element when he wrote for the Court that the Framers of the Constitution drafted the Commerce Clause "to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation."[99] As to the economic element, Chief Justice Rehnquist recognized the dormant Commerce Clause to be based upon an "implicit free market policy."[100] Finally, Justice White encapsulated the political consequences of unrestrained state regulation of interstate commerce: "Unrepresented interests will often bear the brunt of regulations imposed by one State [that have] a significant effect on persons or operations in other States."[101] Representation, of course, is a central feature of American democracy. Each of these policies influences an informed dormant-Commerce-Clause analysis.

[93] *See DiSanto*, 273 U.S. at 37; *Cooley*, 53 U.S. (12. How.) at 319; *Gibbons*, 22 U.S. (9 Wheat.) at 199–200, 203.

[94] *But see, e.g.*, Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 579 (1986) (applying direct/indirect test); Edgar v. MITE Corp., 457 U.S. 624, 640 (1982) (plurality opinion) (applying direct/indirect test).

[95] *See Pike*, 397 U.S. at 142.

[96] *See infra* text accompanying notes 118–123.

[97] *See infra* text accompanying notes 98–101.

[98] CHEMERINSKY, *supra* note 89, at 403–04.

[99] Hughes v. Oklahoma, 441 U.S. 322, 325 (1979) (dictum).

[100] Transcon. Gas Pipe Line Corp. v. State Oil & Gas Bd., 474 U.S. 409, 425 (1986) (Rehnquist, J., dissenting).

[101] S.-Cent. Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 92 (1984) (dictum); *see also* S.C. State Highway Dept. v. Barnwell Bros., 303 U.S. 177, 185 n.2 (1938) (dictum):

> State regulations affecting interstate commerce, whose purpose or effect is to gain for those within the state an advantage at the expense of those without, or to burden those out of the state without any corresponding advantage to those within, have been thought to impinge upon the . . . [Commerce Clause] even though Congress has not acted.

Id.

1. The Modern Approach

The modern approach begins by determining whether a state regulatory measure facially or effectively discriminates against out-of-state commerce in favor of domestic trade.[102] Discriminatory regulations are policies that favor in-state over out-of-state economic interests.[103] Where such favoritism exists, the regulation is almost always invalid.[104] The Supreme Court of the United States has invalidated regulations that prohibited the sale of electricity over state lines without permission from an in-state commission,[105] required a waste disposal fee for out-of-state waste but not in-state waste,[106] and prevented the transport of minnows for sale in other states.[107]

A regulation that does not discriminate must still undergo a balancing test that weighs the local benefits of a challenged regulation against the burden it imposes upon interstate commerce.[108] If the regulation's burden is "clearly excessive" in relation to the local benefits, [109] the law will be invalidated under the dormant Commerce Clause.[110] In *Pike v. Bruce Church, Inc.*,[111] Justice Stewart summarized this test: "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[112]

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[102] *See* Fulton Corp. v. Faulkner, 516 U.S. 325, 331 (1996); W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 201–02 (1994) ("'The commerce clause forbids discrimination, whether forthright or ingenious.'" (quoting Best & Co. v. Maxwell, 311 U.S. 454, 455-56 (1940))). *But see* Exxon Corp. v. Governor of Md., 437 U.S. 117 (1978) (upholding a law preventing out-of-state petroleum refiners from operating gas stations within the state).

[103] *See* Associated Indus. v. Lohman, 511 U.S. 641, 647 (1994) ("The [dormant Commerce] Clause prohibits economic protectionism—that is, 'regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.'" (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 273–74 (1988))).

[104] *Fulton*, 516 U.S. at 331; Lewis v. BT Inv. Managers, Inc., 447 U.S. 27, 36–37 (1980).

[105] New Eng. Power Co. v. New Hampshire, 455 U.S. 331, 337–39 (1982).

[106] Chem. Waste Mgmt., Inc. v. Hunt, 504 U.S. 334, 339–49 (1992).

[107] Hughes v. Oklahoma, 441 U.S. 322, 325 (1979).

[108] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

[109] *Id.*

[110] *See id.*

[111] *Id.*

[112] *Id.* The Court refined this articulation in later cases:

> When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry. When, however, a statute has only indirect ef-

Pike was a case arising out of Arizona's attempt to enforce an order requiring a local cantaloupe grower to pack his harvest in a specific type of container.[113] Normally, the grower packed the cantaloupes in a nearby California facility.[114] The practical effect of the order was to require the grower to build packing facilities within the state and lose the current year's crop to spoilage.[115] The Court found that the burden of having to build local packing facilities outweighed Arizona's interest in having cantaloupes packed in special containers for the purpose of advertisement.[116] The Court explained that it was particularly suspicious of state statutes requiring businesses to perform operations within the home state when they could be more efficiently performed elsewhere.[117]

2. Suspicious Regulations

Although balancing is always the test for validity under the dormant Commerce Clause, some types of regulations are so suspicious that the Supreme Court will almost always invalidate them. For instance, when a state regulates activities taking place wholly outside its borders, the Court will usually invalidate the action.[118] For instance, in *Brown-Forman Distillers Corp. v. New York State Liquor Authority*,[119] the Court struck down a law that required liquor wholesalers to sell in New York at the lowest price that they charged in any other state.[120] The Court noted that the statute had the "'practical effect' of . . . control[ling] liquor prices in other States."[121] The *Pike* test is relevant to analyzing these types of statutes because, to the extent they burden out-of-state transactions, there are no local interests to balance.[122]

> fects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits.

Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 579 (1986) (citations omitted).

[113] *Pike*, 397 U.S. at 138.

[114] *Id.* at 139.

[115] *Id.* at 140.

[116] *Id.* at 145.

[117] *Id.*

[118] *See, e.g.*, Edgar v. MITE Corp., 457 U.S. 624, 642–43 (1982).

[119] 476 U.S. 573 (1986).

[120] *Id.* at 582–83.

[121] *Id.* at 583; *see also* Healy v. Beer Inst., 491 U.S. 324, 337 (1989) (invalidating a Connecticut law requiring liquor wholesalers to "affirm" that their prices were no higher than prices in other states).

[122] *See Edgar*, 457 U.S. at 644 (dictum).

Statutes that subject corporations to inconsistent regulations will also often fail constitutional scrutiny.[123] The Court looks for inconsistency by assessing the practical effect of a regulation against the background of other states' legitimate regulatory regimes, and by imagining its likely effects if all states were to adopt the same or a similar regulation.[124] These regulations are invalidated based on the Court's perceiving "a compelling need for national uniformity in regulation."[125] However, this has happened in only a few cases.[126] In *Bibb v. Navajo Freight Lines*,[127] the Court declared unconstitutional a state law that required trucks to use a particular mudguard when forty-five other states allowed a different type and one state had even outlawed the mudguard that the regulation mandated.[128] In *Southern Pacific Co. v. Arizona* ex rel. *Sullivan*,[129] the Court struck down a law limiting train lengths when neighboring states permitted longer trains.[130] The Court summarized this approach in *CTS Corp. v. Dynamics Corp. of America*,[131] which is discussed below.[132]

B. The Dormant Commerce Clause and Internal Corporate Affairs

It is likely that the Supreme Court of the United States will eventually hear a case concerning the constitutionality of section 2115 or another similar outreach statute.[133] Already the Court has heard cases involving some issues that are sure to arise in this potential litigation. These cases are *Edgar v. MITE Corp.*,[134] *CTS Corp. v. Dynamics Corp. of America*,[135] and *Atherton v. FDIC*,[136] which are important because they offer clues about how the Court will treat an outreach statute under the *Pike* balancing test.

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[123] *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 88 (1987) ("This Court's recent Commerce Clause cases also have invalidated statutes that may adversely affect interstate commerce by subjecting activities to inconsistent regulations."); *see also* Am. Trucking Ass'ns, Inc. v. Mich. Pub. Serv. Comm'n, 545 U.S. 429, 433 (2005).

[124] *Healy*, 491 U.S. at 336–37.

[125] Gen. Motors Corp. v. Tracy, 519 U.S. 278, 300 n.12 (1997) (dictum).

[126] *Id.*

[127] 359 U.S. 520 (1959).

[128] *Id.* at 523, 529.

[129] 325 U.S. 761 (1945).

[130] *Id.* at 763, 781.

[131] 481 U.S 69, 88–89 (1987).

[132] *See infra* Part III.B.2.

[133] *See* Kozyris, *supra* note 19, at 60.

[134] 457 U.S. 624 (1982).

[135] 481 U.S. 69 (1987).

[136] 519 U.S. 213 (1997).

In *VantagePoint*, the Delaware Supreme Court took these clues to mean that *Edgar* and *CTS* support the internal affairs doctrine.[137] Many of *VantagePoint*'s citations, however, misconstrue the context of the Supreme Court of the United States' discussions. Although *VantagePoint* relies on both *Edgar* and *CTS* to support the contention that the Constitution mandates the internal affairs doctrine, these cases contain discussions that consider criteria aside from technical incorporation, in order to help determine the magnitude of a state's interest in a corporation.[138] *Atherton* contains a similar discussion.[139] This authority undermines *VantagePoint*'s assertion that *Edgar* and *CTS* support the constitutional bases of the internal affairs doctrine. It also suggests that outreach statutes containing enough jurisdictional hooks may survive dormant-Commerce-Clause scrutiny.

1. *Edgar v. MITE Corp.*[140]

Edgar involved a Delaware corporation that initiated a tender offer for shares of an Illinois corporation.[141] It was not a pure internal-affairs case because tender offers implicate transactions with third parties and create issues extending beyond a corporation's internal relations.[142] Illinois had a hostile takeover statute that required a tender offeror to comply with several regulations that significantly delayed the proposed transaction.[143] The law applied if the targeted corporation met two of three conditions: it had its principal office in Illinois, was incorporated in Illinois, or had "at least 10% of its stated capital and paid-in surplus represented in Illinois."[144] The Supreme Court struck down the statute because it violated, among other things, the dormant Commerce Clause.[145]

Justice White applied two different dormant-Commerce-Clause standards to the Illinois statute and found that it was unconstitutional

[137] *See* VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 *passim* (Del. 2005).

[138] *See* discussion *infra* Parts III.B.1–2.

[139] *See* discussion *infra* Part III.B.3.

[140] 457 U.S. 624.

[141] *Id.* at 627.

[142] *See id.* at 645 (dictum) ("Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company.").

[143] *See id.* at 626–27.

[144] *Id.* at 642.

[145] *See id.* at 640. The court also found that the Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2000 & Supp. I 2002), superseded Illinois law under the Supremacy Clause, U.S. CONST. art. VI, § 1, cl. 2. *Edgar*, 457 U.S. at 639.

under both.[146] The first, which did not carry a majority of the Court,[147] was the old bright-line direct/indirect test.[148] Under this test, the statute failed because it directly regulated interstate commerce.[149] The second standard, which five Justices endorsed,[150] found the statute's burdens to be too great under the *Pike* test.[151] Justice White identified specific burdens and benefits to balance when applying the standard.[152]

The statute's burdens on interstate commerce included depriving shareholders the opportunity to sell their shares at a premium, hindering the shares' reallocation to a higher valued use and reducing the incentive for management to keep stock prices high, all of which occurred on a nationwide scale.[153] The regulation's national scope amplified its hindrance of efficiency and competition.[154] The only countervailing local interest that the Court unequivocally recognized was Illinois' interest in protecting local investors, but so far as the statute burdened out-of-state transactions, the Court found there was no local state interest to be weighed.[155] Diminishing the gravity of this interest, Justice White opined that the regulation's actual protection of local investors was "speculative."[156]

The defendant argued that the internal affairs doctrine was also a local benefit that weighed against the burdens imposed on interstate commerce.[157] The argument failed because "[t]he 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 foreign corporations."[158] The

[146] *Id.* at 643 (plurality opinion) ("Because the Illinois Act . . . regulate[s] directly . . . it must be held invalid . . . . The Illinois Act is also unconstitutional under the test of *Pike v. Bruce Church, Inc.* . . . .").

[147] *Id.* at 625 (plurality opinion).

[148] *Id.* at 641–43 (plurality opinion); *see supra* note 94.

[149] *Edgar*, 457 U.S. at 643 (plurality opinion).

[150] *Id.* at 625.

[151] *Id.* at 643–46.

[152] *Id.* (dictum).

[153] *See id.* at 643–44 (dictum) (citing Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1173–74 (1981); Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 5, 27–28, 45 (1978)).

[154] *See id.* (dictum).

[155] *Edgar*, 457 U.S. at 644.

[156] *Id.* at 645 (dictum).

[157] *Id.* at 645 ("Appellant also contends that Illinois has an interest in regulating the internal affairs of a corporation incorporated under its laws.").

[158] *Id.* at 645–46.

VantagePoint court relied on the second sentence of this dictum in order to support its application of the internal affairs doctrine under the dormant Commerce Clause.[159]

In isolation, the "no interest" language suggests that outreach statutes will inevitably fail the *Pike* balancing test because they designedly regulate the internal affairs of foreign corporations. However, the context suggests otherwise. The *Edgar* court analysis, regarding the "principal place of business,"[160] which the *VantagePoint* court did not reprint, shows that the Supreme Court of the United States might consider traits beyond paper incorporation when determining a corporation's domicile—at least for the limited purpose of analyzing internal-affairs regulations under the dormant Commerce Clause. In *Edgar*, the "principal place of business," in addition to the state of incorporation, was relevant to this determination.[161]

Delaware law does not use the "principal place of business" as a factor in determining a corporation's domestic or foreign identity under the internal affairs doctrine; the sole issue is technical incorporation.[162] And the Supreme Court might generally agree with this determination of identity under state law, but it does not necessarily follow that an identical standard applies under the dormant Commerce Clause. *VantagePoint*'s reliance on *Edgar* is overstated insofar as it assumes that regulating a foreign corporation is always equivalent to regulating foreign interests. An outreach statute such as section 2115[163] contains extensive criteria to identify where a corporation primarily exists.[164] By identifying this primary location, the statute, in effect, identifies whether local interests predominate. This statutory determination, when valid, avoids the constitutional problems that the Supreme Court discerns when a state does not have local interests to balance against the burden of regulating corporations formed by other states.

[159] *See* VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1112–13 (Del. 2005).

[160] *See supra* text accompanying note 158.

[161] *Edgar*, 457 U.S. at 645–46.

[162] *VantagePoint*, 871 A.2d at 1112 ("[O]nly one state should have the authority to regulate a corporation's internal affairs—the state of incorporation.").

[163] CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006).

[164] *Id.* § 2115(a).

2. *CTS Corp. v. Dynamics Corp. of America*[165]

CTS, like *Edgar*, involved a state anti-takeover statute,[166] the Williams Act,[167] and the dormant Commerce Clause.[168] This time, though, the Court upheld the takeover statute because it neither discriminated against interstate commerce nor subjected it to inconsistent regulation.[169] Unlike the statute at issue in *Edgar*, this one regulated tender offers involving only domestically chartered corporations.[170]

Justice Powell found that the statute did not discriminate against interstate commerce either facially or in practical effect.[171] Facially, it had a uniform effect on tender offers, without regard to whether the initiator was an Indiana resident or domiciliary.[172] The Justice found that its practical effect did not evidence discrimination either, even though more tender offers came from outside the state than from within it.[173] "'The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce.'"[174]

The Indiana statute requires that those seeking control shares must gain approval from a majority of the target corporation's shareholders before being able to exercise the voting rights of the acquired shares.[175] This mechanism has the practical effect of conditioning "acquisition of control of a corporation on approval of a

[165] 481 U.S. 69 (1987).

[166] IND. CODE ANN. §§ 23-1-42-1 to -11 (West 2005).

[167] 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2000 & Supp. I 2002).

[168] *CTS*, 481 U.S. at 72.

[169] *Id.* at 88–89.

[170] The Indiana Act only applies to "issuing public corporation[s]," which are defined as corporations having:

> (1) One hundred (100) or more shareholders;
> (2) Its principal place of business, its principal office, or substantial assets within Indiana; and
> (3) Either:
>> (A) More than ten percent (10%) of its shareholders resident in Indiana;
>> (B) More than ten percent (10%) of its shares owned by Indiana residents; or
>> (C) Ten thousand (10,000) shareholders resident in Indiana.

IND. CODE ANN. § 23-1-42-4(a) (West 2005).

[171] *CTS*, 481 U.S. at 87–88.

[172] *Id.* at 87.

[173] *Id.* at 88.

[174] *Id.* (quoting Exxon Corp. v. Governor of Md., 437 U.S. 117, 126 (1978)).

[175] IND. CODE ANN. § 23-1-42-9 (West 2005).

majority of the pre-existing disinterested shareholders."[176] Justice Powell defended the validity of the statute by emphasizing Indiana's legitimate interest in regulating the corporations it charters:

> 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. No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders.[177]

Although the Justice emphasized the state of incorporation as having an interest in "the corporations it has created,"[178] he added that "unlike the Illinois statute invalidated in *Edgar*, the Indiana statute applies only to corporations that have a substantial number of shareholders in Indiana. Thus, every application of the Indiana Act will affect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting."[179] This is in line with *Edgar*'s theme of considering characteristics beyond technical incorporation in order to determine a state's interest in regulating a corporation's internal affairs.

CTS's positive treatment of a state's interest in governing the internal affairs of its corporations should not be overemphasized, as it was in *VantagePoint*.[180] Undoubtedly, a state's right to govern the internal affairs of its corporations is one interest out of many to be weighed in the *Pike* balancing test, but as Professor Nat Stern observed: "[I]t is the protection of individuals and entities in whom the state has a direct interest, not an abstract apotheosis of the [internal affairs doctrine], that lies at the heart of *CTS*'s approval of the Indiana statute."[181] Professor Stern concluded that when individual interests are implicated, "it would be ironic if technical incorporation in a

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[176] *CTS*, 481 U.S. at 74.

[177] *Id.* at 89.

[178] *Id.*

[179] *Id.* at 93 (citation omitted).

[180] The *VantagePoint* court repeatedly relied on *CTS* to support the internal affairs doctrine. VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1112 (Del. 2005); *id.* at 1113 ("It is now well established that only the law of the state of incorporation governs and determines issues relating to the internal affairs of a corporation." (citing *CTS*, 481 U.S. at 89–93)); *id.* at 1115 (emphasizing importance of stability in intracorporate relationships (citing *CTS*, 481 U.S. at 95)); *id.* at 1116 (quoting *CTS*, 481 U.S. at 89); *id.* at 1118 (indicating the broad acceptance of the internal affairs doctrine (citing *CTS*, 481 U.S. at 89–90)).

[181] Nat Stern, *Circumventing Lax Fiduciary Standards: The Possibility of Shareholder Multistate Class Actions for Directors' Breach of the Duty of Due Care*, 72 NEB. L. REV. 1, 52–53 (1993).

state—often little more than a formality—were to carry more weight than residency."[182]

3. *Atherton v. FDIC*[183]

The *Atherton* Court considered a case where the Federal Deposit Insurance Corporation ("FDIC") acted as receiver for a federally chartered bank, in order to defend allegations that its directors breached a fiduciary duty.[184] The legal controversy was whether to apply federal common law, instead of state law, in determining the directors' standard of care.[185] The FDIC argued for applying federal law, because the otherwise applicable state law would have held the directors to a higher standard of care and increased the chances of the Court finding a breach of fiduciary duty.[186] The Court held that, despite the bank's federal charter, state law controls a director's standard of care, so long as the state standard is stricter than the federal standard.[187]

The case is less relevant to this Comment than *Edgar* or *CTS*, and *VantagePoint* does not mention the case; however, the Court extensively analogized its decision to an analysis under the internal affairs doctrine.[188] This analogy shows how the Court might determine a corporation's domicile when it is necessary to consider factors beyond technical incorporation. Justice Breyer justified the Court's decision to apply state law: "The internal affairs doctrine shows no [need to create federal common law when a conflict with state law occurs], for it seeks only to avoid conflict by requiring that there be a single point of legal reference. Nothing in that doctrine suggests that the single source of law must be federal."[189] The Justice continued:

> In the absence of a governing federal common law, courts applying the internal affairs doctrine could find (we do not say that they will find) that the State closest analogically to the State of incorporation of an ordinary business is the State in which the federally chartered bank has its main office or maintains its principal place of business.[190]

[182] *Id.* at 53.
[183] 519 U.S. 213 (1997).
[184] *Id.* at 215–16.
[185] *Id.*
[186] *See id.*
[187] *Id.* at 216.
[188] *Id.* at 224.
[189] *Atherton*, 519 U.S. at 224.
[190] *Id.*

This analogy effectively describes the elements, aside from technical incorporation, of a domestic corporation.

Having a main office and maintaining a local principal place of business were factors that the Justice considered to be "stand-ins" for actual incorporation.[191] In this case, because the bank was federally chartered, and therefore lacked a state of incorporation, the Court used the factors to determine which state had the greatest interest in regulating the bank's internal affairs. In *Edgar* and *CTS*, the Court considered the same elements when it balanced interests under *Pike*, although because these cases involved state corporations, and not a federally chartered bank, the place of incorporation was an additional factor.[192] What remains for the Court to decide is whether a state possessing enough of these "stand-ins" has a greater interest in regulating internal affairs than a state possessing technical incorporation and fewer "stand-ins."

To the extent that *VantagePoint* relied on the aforementioned cases to show that the technical state of incorporation always has the greatest interest in regulating a corporation, the reliance was misplaced. In all three cases the Court looked to factors beyond the mere place of incorporation, to determine where the interests lay. In *VantagePoint*, the Delaware Supreme Court might have been able to find that the factors weighed in favor of Delaware's interests, but, if so, it should have applied the *Pike* balancing test. Instead, the court leapt to the conclusion that the internal affairs doctrine was constitutionally mandated.

This leap undermines the holding, because without a separate dormant-Commerce-Clause analysis, the *VantagePoint* court's approach to the constitutional permissibility of outreach statutes collapses into a determination of whether or not a state regulation violates the internal affairs doctrine. But even if a regulation violates the internal affairs doctrine, it does not necessarily follow that it fails dormant-Commerce-Clause scrutiny. The constitutional principle stands on its own, without the aid of state judicial doctrines. It is *Pike*, and not *VantagePoint*, that courts must use to assess the constitutionality of outreach statutes.

C. Section 2115 and the Dormant Commerce Clause

Section 2115 is the logical extension of *Edgar*'s and *CTS*'s theme, and is consistent with the discussion in *Atherton*. The outreach statute

[191] *See id.*
[192] *See supra* Part III.B.1–2.

possesses specific jurisdictional limiters that address the Supreme Court's primary constitutional concerns.[193] As held by a California appellate court in *Wilson v. Louisiana-Pacific Resources, Inc.*,[194] section 2115 does not discriminate, nor does it place an inordinate burden upon interstate commerce.[195] *Wilson*, however, is just a starting point, as it was decided before *CTS*, and only shortly after *Edgar*. *Wilson* provides a strong framework for assessing outreach statutes under the dormant Commerce Clause. And when one compares section 2115 to the statute upheld in *CTS*, the *Wilson* framework appears even stronger.

Wilson came up on an appeal by defendant Louisiana-Pacific Resources, Inc. ("Louisiana-Pacific") to overturn the lower court's declaratory judgment that the corporation was subject to section 2115 and that section 2115 did not violate the U.S. Constitution.[196] Louisiana-Pacific was a Utah corporation that had maintained itself primarily in California for at least ten years prior to the litigation.[197] In affirming the lower court's judgment, the court applied the *Pike* balancing test to section 2115 and determined that the statute was constitutional under the dormant Commerce Clause.[198] The court also found that the statute was constitutional under the Full Faith and Credit Clause,[199] the Due Process Clause of the Fourteenth Amendment,[200] the Contract Clause,[201] and the Equal Protection Clause of the Fourteenth Amendment.[202]

First, the court applied *Pike*'s discrimination threshold test.[203] The court observed that section 2115 regulates even-handedly because it applies the same laws to foreign corporations as it does to its own corporations, and places no additional burdens on "out-of-state interests."[204] This is actually truer today than it was when *Wilson* was

193 *See* CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006).

194 187 Cal. Rptr. 852 (Cal. Ct. App. 1982).

195 *Id.* at 861 ("We conclude that to the extent that the cumulative voting requirement imposed by section 2115 upon pseudo-foreign corporations is shown to have any effect upon interstate commerce, the effect is incidental, and minimal in relation to the purpose which that requirement is designed to achieve.").

196 *Id.* at 854–55.

197 *Id.*

198 *Id.* at 858–61.

199 U.S. CONST. art. IV, § 1.

200 *Id.* amend. XIV, § 1.

201 *Id.* art. I, § 10, cl. 1.

202 *Id.* amend. XIV, § 1; Wilson v. L.A.-Pac. Res., Inc., 187 Cal. Rptr. 852, 862–63 (Cal. Ct. App. 1982).

203 *Wilson*, 187 Cal. Rptr. at 859.

204 *Id.*

decided. Previously, section 2108 of the California Corporations Code required foreign corporations to file an annual statement as to whether they met the tests under section 2115(a), or else forfeit the right to transact business within the state.[205] Before the section was repealed, it was arguably a burden that only foreign corporations had to bear. The repeal of section 2108 enhanced the evenhandedness of section 2115 by removing a minor but significant discriminatory element.

The court next turned to balancing under *Pike*.[206] The principle burden of section 2115 on interstate commerce is its potential to subject corporations to inconsistent regulations from year to year based on rapidly changing financial conditions.[207] The *Wilson* court addressed this argument by first pointing out that the statute cannot conflict with another state's regulations, so long as all states require majority contacts, before regulating foreign corporations:

> The potential for conflict and resulting uncertainty from California's statute is substantially minimized by the nature of the criteria specified in section 2115. A corporation can do a majority of its business in only one state at a time; and it can have a majority of its shareholders resident in only one state at a time. If a corporation meets those requirements in this state, no other state is in a position to regulate the method of voting by shareholders on the basis of the same or similar criteria. It might also be said that no other state could claim as great an interest in doing so. In any event, it does not appear that any other state has attempted to do so. If California's statute were replicated in all states, no conflict would result. We conclude that the potential for conflict is, on this record, speculative and without substance.[208]

As the court further explained, section 2115 is completely different than the Illinois statute invalidated in *Edgar*,[209] where many states could have potentially applied the same kind of regulation.[210] The court also found that the burden under the "worst-case scenario" was that a corporation might be subject to California substantive law, which was not an unreasonable burden.[211]

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[205] CAL. CORP. CODE § 2108(d) (West 1990) (repealed 1997).
[206] *Wilson*, 187 Cal. Rptr. at 858–61.
[207] *See* DeMott, *supra* note 9, at 166.
[208] *Wilson*, 187 Cal. Rptr. at 860 (footnotes omitted).
[209] *See* discussion *supra* Part III.C.1.
[210] *Wilson*, 187 Cal. Rptr. at 860 n.6.
[211] *See id.*

Section 2115 is more like the Indiana statute upheld in *CTS*.[212] The Supreme Court of the United States found the Indiana statute to be valid, in part because it preserved a regime under which corporations are subject to a single law.[213] The statute's applicability to only Indiana corporations avoided the danger of the Court's perceiving it as conflicting with other states' regimes, which would generally be an impermissible burden.[214] Section 2115 accomplishes the same goal, albeit with the significance of its required contacts as opposed to the requirement of technical incorporation.[215] The potential for all states to enact an identical regulation without conflict is consistent with the Supreme Court's recognizing a "compelling need for [regulatory] uniformity."[216]

Setting aside the issue of technical incorporation, section 2115 implicates far greater state interests than the Indiana statute does. Proportionally, section 2115 will always apply to a far greater number of shareholders than will the Indiana statute.[217] Section 2115 also requires that the majority of shareholders, property, and payroll are in California.[218] Finally, section 2115 never applies to publicly traded corporations.[219]

By contrast, the Indiana statute requires a corporation to have at minimum one hundred shareholders and either "[i]ts principal place of business, its principal office, or substantial assets within Indiana."[220] Furthermore, it requires either more than ten percent of shareholders to be Indiana residents, more than ten percent of the shares to be owned by Indiana residents, or ten thousand shareholders to reside in Indiana.[221] So, in a corporation of one thousand shareholders, Indiana law would apply if only one shareholder held over ten percent of the shares and the corporation had "substantial assets" in the state. The required percentage might be even lower than ten percent, because institutional holdings are excluded from the calcula-

[212] *See supra* note 166 and accompanying text.

[213] CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987) (dictum); *see supra* text accompanying note 177.

[214] *See supra* notes 123–125 and accompanying text.

[215] *See* CAL. CORP. CODE § 2115(a) (West 1990 & Supp. 2006).

[216] *Cf.* Gen. Motors Corp. v. Tracy, 519 U.S. 278, 300 n.12 (1997) (dictum).

[217] *Compare* § 2115(a), *with* IND. CODE ANN. §§ 23-1-42-1 to -11 (West 2005). The pertinent text of the Indiana statute is reprinted in this Comment's discussion of *CTS*. *See supra* note 170.

[218] § 2115(a).

[219] *See id.* § 2115(e).

[220] IND. CODE ANN. §§ 23-1-42-4(a)(1)-(2) (West 2005).

[221] *Id.* §§ 23-1-42-4(a)(3)(A)-(C).

tion.[222] Under section 2115, the same corporation (although unlikely to exist as a closely held corporation) would require 501 shareholders to be state residents and over fifty percent of property and business to be in the state.

Although the *CTS* court recognized that the "substantial number of Indiana residents" affected by the statute weighed favorably in the *Pike* balancing test,[223] the statute would certainly have been invalidated if it applied to corporations chartered in other states.[224] The fact of incorporation was necessary to overcome the statute's relatively meager contacts requirement. But section 2115 overcomes this problem differently, through its predominant contacts requirement and its exclusion of public corporations.[225] By requiring such strict contacts, it lessens the need for the legal fiction of incorporation.

IV. CONCLUSION

So long as the United States adheres to its current incorporation scheme, narrowly tailored outreach statutes should be a permissible part of determining the substantive law governing a corporation's internal affairs. Without such statutes, states have no ability to protect their domestic corporate actors, and they cannot promote internal practices that facilitate sound corporate decision-making. Outreach statutes similar to section 2115 can avoid dormant-Commerce-Clause dangers by making sure to require predominant contacts before they apply.[226] Furthermore, restricting application to closely held corporations minimizes the effect on the free-flow of capital in the national markets.

The internal affairs doctrine has long reigned supreme, and there is no reason to think it will not continue to do so. Its main competitors, including section 2115, are comparatively narrow exceptions to the doctrine's general rule. A more credible threat to its supremacy is the potential expansion of federal corporate law.[227] Since this threat has not yet manifested, some states have enacted outreach statutes, which are essentially a means of asserting their right to govern subject matter that affects them more than it affects any other state. This may not be the most efficient way to do business on a na-

[222] IND. CODE ANN. § 23-1-42-4 cmt. c (LexisNexis 2006).

[223] *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 93 (1987).

[224] *See id.* at 91 (by implication).

[225] *See* CAL. CORP. CODE § 2115(a), (e) (West 1990 & Supp. 2006).

[226] *See* text accompanying notes 212–219.

[227] *See supra* note 46 and accompanying text.

tional or international scale, but it is a reasonable compromise between local state interests and federal constitutional restraints.