INTERNAL AFFAIRS DOCTRINE: CALIFORNIA VERSUS DELAWARE IN A FIGHT FOR THE RIGHT TO REGULATE FOREIGN CORPORATIONS

Abstract: The Internal Affairs Doctrine ("IAD") has traditionally been a categorical rule mandating that in corporate conflict-of-laws scenarios, only the incorporating state has the right to regulate a corporation's internal affairs. California has created a statutory exception to the IAD, however, that allows regulation of the internal affairs of out-of-state corporations in limited circumstances. In 2005, in *VantagePoint Venture Partners 1996 v. Examen, Inc.*, the Supreme Court of Delaware rejected California's statutory exception and its associated public policy in an attempt to reestablish the status quo of the IAD as an absolute mandate. This Note offers a critique of the *VantagePoint* opinion and argues that California's statutory exception should be universally accepted. This Note also suggests that the real motivation driving the *VantagePoint* court's decision to reject an exception to the IAD may have been to protect Delaware's lucrative corporate chartering business and annual franchise tax revenues.

INTRODUCTION

In the United States, a prospective corporation is free to incorporate in any state, regardless of where the corporation plans to locate physically or transact business.[1] Where the corporate organizers reside and whether the corporation has any actual ties to the chosen state of incorporation are factors of no consequence.[2] The state that a corporation chooses is extremely important, however, because states generally have the exclusive right to regulate the internal affairs[3] of corpo-

[1] Stanley A. Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 435 (1968); *see* Guhan Subramanian, *The Influence of Anti-Takeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and an Anti-Takeover Overreaching*, 150 U. PA. L. REV. 1795, 1802–03 (2002); Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 44 (2006).

[2] Subramanian, *supra* note 1, at 1802 (stating that corporations are not constrained by the location of their headquarters, manufacturing facilities, places of business, or any other operational factors in deciding where to incorporate); Tung, *supra* note 1, at 44.

[3] Internal affairs include: steps taken in the course of the original act of incorporation, adoption of bylaws, issuance or reclassification of shares of corporate stock, holding director and shareholder meetings, declaration and payment of dividends, charter amendments, mergers, consolidations, reorganizations, and corporate purchases of outstanding shares of its own stock. *In re* Harnischfeger Indus., Inc., 293 B.R. 650, 662 (Bankr. D. Del.

rations incorporated under their laws.[4] This exclusive right of regulation is known as the Internal Affairs Doctrine (the "IAD").[5]

The IAD replaces the standard conflict-of-laws principles that apply in most other areas of law.[6] Conflict-of-laws scenarios arise frequently in corporate law due to the multistate and multinational operational capabilities and characteristics of many corporations.[7] The typical scenario occurs when a corporation chooses to incorporate in one state but actually transacts most or all of its business in other states, thus implicating different standards of law.[8] When a corporation operates in states other than its incorporating state, it is referred to as a "foreign" corporation in those other states.[9]

In these situations, the IAD traditionally has been a categorical rule giving the incorporating state the sole right and responsibility to regulate the internal affairs of its corporations.[10] The rationale be-

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2003) (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. e (1971)). For a detailed discussion of the distinction between internal affairs corporate law and corporate law that is external to an individual corporation and thus not regulated by the Internal Affairs Doctrine, see Theresa Gabaldon, *The Story of Pinocchio: Now I'm a Real Boy*, 45 B.C. L. REV. 829, 840–41 (2004).

[4] *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89–90 (1987); Edgar v. MITE Corp., 457 U.S. 624, 645 (1981); Shaffer v. Heitner, 433 U.S. 186, 215 n.44 (1977); McDermott Inc. v. Lewis, 531 A.2d 206, 215 (Del. 1987); *see also* J. Thomas Oldham, *California Regulates Pseudo-Foreign Corporations—Trampling upon the Tramp?*, 17 SANTA CLARA L. REV. 85, 85 (1977). Decisions concerning corporate internal affairs are extremely significant because they involve matters which are peculiar to the relationships among or between the corporation and its officers, directors, and shareholders. *MITE*, 457 U.S. at 645.

[5] *See MITE*, 457 U.S. at 645.

[6] *See id.*; *Shaffer*, 433 U.S. at 215; *McDermott*, 531 A.2d at 215; *see also* Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 LAW & CONTEMP. PROBS. 135, 137–38 (2004); Oldham, *supra* note 4, at 1.

[7] *See CTS Corp.*, 481 U.S. at 90; *McDermott*, 531 A.2d at 216; Deborah DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161, 172 (1985).

[8] *See* Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 855 (Ct. App. 1983); W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 720 (Ct. App. 1961).

[9] *See* VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1110 n.1 (Del. 2005). The California Corporations Code broadly defines the term "foreign corporation" to mean any corporation other than one chartered under the laws of the United States. *See* CAL. CORP. CODE § 171 (West 2006) (defining "foreign corporation"); *id.* § 2115 (using the term throughout the section). Courts have adopted the term "foreign corporation," however, to mean any corporation incorporated out of state. *See, e.g.*, *VantagePoint*, 871 A.2d at 1009–10 n.1 (explaining the operation of the California regulatory scheme). In *VantagePoint*, for example, the Supreme Court of Delaware explained that "[s]ection 2115 of the California Corporations Code purportedly applies to corporations that have contacts with the State of California, but are incorporated in other states." *Id.*

[10] *See* State Farm Mut. Auto Ins. Co. v. Super. Ct. of L.A. County, 8 Cal. Rptr. 3d 56, 64 (Ct. App. 2003); *VantagePoint*, 871 A.2d at 1112–13; *McDermott*, 531 A.2d at 215. The most accepted theory of how and why the IAD developed is that it was meant to protect multistate corporations from the inconsistent and ever-changing legal standards of multiple jurisdictions. *See VantagePoint*, 871 A.2d at 1112.

hind the IAD is that subjecting the internal affairs of a corporation to the laws of only one state is consistent with the expectations of its organizers, and makes corporate decision making more predictable and reliable.[11] Thus, no matter how attenuated a corporation's contacts with the incorporating state, nor how significant its contacts with non-incorporating states, the incorporating state will have the exclusive authority to regulate the corporation's internal affairs.[12]

Several states have resisted this seemingly absolute right of an incorporating state to regulate internal affairs.[13] Most notably, in 1977, the California legislature enacted Corporations Code section 2115 to allow the state to regulate all corporations that conduct a majority of their business in California, even if they are incorporated elsewhere and thus considered foreign corporations.[14] The statute is not meant to eliminate or override the regulatory rights of the incorporating state, but rather to add another layer of protection for California shareholders and other stakeholders in those foreign corporations.[15]

Although courts in California have upheld section 2115,[16] Delaware courts have refused to recognize any exception to the IAD and have sharply criticized California's section 2115.[17] The conflict between these two states is noteworthy because they are two of the most significant jurisdictions in the development of corporate law—more than sixty percent of all Fortune 500 companies are incorporated in Delaware, for example, and approximately twenty percent are headquartered in California.[18] Consequently, the unsettled state of the law

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[11] *See id.* at 1113.

[12] *See State Farm*, 8 Cal. Rptr. 3d at 64; *VantagePoint*, 871 A.2d at 1113; *McDermott*, 531 A.2d at 215; *see also* Greenfield, *supra* note 6, at 138.

[13] *See* CAL. CORP. CODE § 2115; N.Y. BUS. CORP. LAW §§ 1319–1320 (Consol. 2006); Weede v. Iowa S. Utils. of Del., 2 N.W.2d 372, 395 (Iowa 1942); *see also* DeMott, *supra* note 7, at 164.

[14] CAL. CORP. CODE § 2115.

[15] *See id.* legislative committee cmt. California has imposed a mandatory cumulative voting requirement for all corporate shareholders, for example, and has increased the duties of corporate fiduciaries. *See id.*

[16] *See State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 863.

[17] *See VantagePoint*, 871 A.2d at 1113–15; *McDermott*, 531 A.2d at 218–19.

[18] *See Our Annual Ranking of America's Largest Corporations*, FORTUNE 500, Apr. 17, 2006, http://money.cnn.com/magazines/fortune/fortune500/states/C.html (showing the large list of Fortune 500 companies that are headquartered in California); State of Delaware Division of Corporations, http://www.state.de.us/corp/aboutagency.shtml (last visited July 6, 2007) (explaining that Delaware is the leading state of incorporation in the United States and that sixty percent of the Fortune 500 has incorporated there); *The Largest Private Companies*, FORBES.COM, Nov. 9, 2006, http://www.forbes.com/lists/2006/21/biz_06privates_The-Largest-Private-Companies-CA_3Rank.html (showing the list of all large private companies that are headquartered in California).

governing internal affairs affects a substantial number of the largest corporations in the country.[19]

As long as these two states continue to disagree, the fates of many corporations litigating internal affairs issues hang in the balance.[20] Lawsuits filed in California are being adjudicated under section 2115, while lawsuits filed in Delaware are being adjudicated according to the IAD, and so corporations with ties to both states have reason to be uncertain as to which standards will be applied.[21]

The crux of this problem recently appeared in 2005 in *Vantage-Point Venture Partners 1996 v. Examen, Inc.*, where the Supreme Court of Delaware refused to acknowledge the California statute in Delaware and instead reaffirmed the IAD as a categorical rule.[22] The corporation at issue was incorporated in Delaware, but operated almost exclusively in California, and was exactly the type of business that section 2115 was meant to regulate.[23] The Supreme Court of Delaware, however, decided that because the state of incorporation was Delaware, the corporation did not have to abide by California's internal affairs regulations.[24]

This Note argues that the Delaware court erred in rendering this decision and that California Corporations Code section 2115 should be accepted as a valid exception to the IAD.[25] In certain situations, a non-incorporating state should have the right to regulate foreign corporations operating significantly within it.[26] Part I examines the history of this type of regulation in California and traces the state's steps in creat-

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[19] *See Our Annual Ranking of America's Largest Corporations*, *supra* note 18; State of Delaware Division of Corporations, *supra* note 18; *The Largest Private Companies*, *supra* note 18.

[20] *See, e.g.*, Levi Strauss & Co., Quarterly Report (Form 10Q) (Apr. 10, 2007), *available at* http://sec.gov/Archives/edgar/data/94845/000095014907000118/f29008e10vq.htm [hereinafter Levi Strauss Form 10Q]; *The Largest Private Companies*, *supra* note 18. For example, Levi Strauss & Co., America's 53rd largest private corporation and America's 484th largest corporation overall, is incorporated in Delaware. *See* Levi Strauss Form 10Q, *supra*; *The Largest Private Companies*, *supra* note 18. Levi Strauss & Co., however, is headquartered and has significant business operations in California. *See Our Annual Ranking of America's Largest Corporations*, *supra* note 18. Therefore, because it is a privately held corporation incorporated in Delaware but operating significantly in California, it could potentially fall under the purview of California's regulation of foreign corporations. *See* CAL. CORP. CODE § 2115 (West 2006).

[21] *Compare VantagePoint*, 871 A.2d at 1113–15 (upholding the use of the IAD as a categorical rule in Delaware), *and McDermott*, 531 A.2d at 218–19 (upholding the use of the IAD as a categorical rule in Delaware), *with Wilson*, 187 Cal. Rptr. at 863 (using section 2115 as an exception to the IAD and applying California law to the exclusion of the law of the state of incorporation).

[22] *See* 871 A.2d at 1109–11.

[23] *See* CAL. CORP. CODE § 2115; *VantagePoint*, 871 A.2d at 1110–11.

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

[25] *See infra* notes 32–323 and accompanying text.

[26] *See infra* notes 32–323 and accompanying text.

ing section 2115.[27] Part II discusses relevant case law from other jurisdictions that have adopted similar forms of regulation.[28] Part III explores the history of the treatment of the IAD as a categorical rule in Delaware.[29] Part IV analyzes the Supreme Court of Delaware's decision in *VantagePoint* and critiques the court's reasoning and conclusion.[30] Finally, Part V outlines the errors in the *VantagePoint* opinion and suggests that the real motivation driving Delaware's decision to reject section 2115 as an exception to the IAD was protecting the state's corporate chartering business.[31]

I. Regulation of Corporate Internal Affairs in California

California has a long history of regulating corporations operating inside its borders, even when they are incorporated elsewhere.[32] It does so to protect those California residents who have a personal stake in the corporations' prospects as stockholders, creditors, employees, or suppliers.[33] This type of regulation stems from the Constitution of the State of California of 1879 and has become embedded in the state's subsequent statutory and common law.[34] Currently, section 2115 of the California Corporations Code operates to regulate the internal affairs of foreign corporations.[35] The California courts have interpreted the statute to provide a necessary exception to the traditional default rule of the IAD, using it to resolve corporate conflict-of-laws issues.[36]

The statutory framework of section 2115 is simply stated: if a corporation meets a series of prerequisites, thereby establishing significant business contacts in California, the state has the right to regulate

[27] *See infra* notes 32–113 and accompanying text.

[28] *See infra* notes 114–153 and accompanying text.

[29] *See infra* notes 154–197 and accompanying text.

[30] *See infra* notes 198–231 and accompanying text.

[31] *See infra* notes 232–323 and accompanying text.

[32] *See, e.g.*, Provident Gold Mining Co. v. Haynes, 159 P. 155, 156–57 (Cal. 1916); Friese v. Super. Ct. of San Diego, 36 Cal. Rptr. 3d 558, 569 (Ct. App. 2005); State Farm Mut. Auto Ins. Co. v. Super. Ct. of L.A. County, 8 Cal. Rptr. 3d 56, 68 (Ct. App. 2003); W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 727 (Ct. App. 1961).

[33] *See, e.g.*, *Provident*, 159 P. at 156, 157.

[34] *See* Cal. Const. art. XII, § 15 (repealed 1972) (from 1879 until 1972, article XII, section 15 of the Constitution of the State of California stated that "[n]o corporation organized outside the limits of this State shall be allowed to transact business within this State on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this State"); Cal. Corp. Code § 2115 (West 2006); *Provident*, 159 P. at 156, 157; *Friese*, 36 Cal. Rptr. 3d at 568–69; *State Farm*, 8 Cal. Rptr. 3d at 69; Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 863 (Ct. App. 1983); *Sobieski*, 12 Cal. Rptr. at 727.

[35] *See* Cal. Corp. Code § 2115.

[36] *See, e.g.*, *Provident*, 159 P. at 156, 157; *State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 863.

that corporation's internal affairs.[37] The policy underlying the statute is also simply stated: California should have the opportunity to regulate any corporation that relies on its residents and resources to sustain in-state operations, regardless of where it has chosen to incorporate.[38] California courts have enforced section 2115 several times in recent history, but they have not always strictly followed the tenets of this policy.[39] In certain situations, the courts have recognized that the need for predictability justifies the use of the IAD rather than section 2115 to resolve internal affairs disputes.[40]

A. *The Basic Framework: California Corporations Code Section 2115*

Section 2115 is a narrowly tailored statute that applies to nonpublic corporations that have significant business operations in California, but are incorporated elsewhere.[41] The statute was created by the California legislature with the express purpose of policing out-of-state corporations that rely on California residents for the success of their business operations, yet incorporate elsewhere to take advantage of more lenient regulatory standards.[42] Traditionally, due to the IAD, only the state of incorporation may regulate corporate internal affairs.[43] Section 2115, therefore, operates as an exception to the IAD by allowing California to regulate foreign corporations operating substantially within the state.[44] In effect, the statute applies additional regulations to corporations conducting business in California, notwithstanding any regulations already imposed by the actual state of incorporation.[45]

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[37] *See* Cal. Corp. Code § 2115.

[38] *See id.* legislative committee cmt.; *Provident*, 159 P. at 156–57; *Wilson*, 187 Cal. Rptr. at 857; *Sobieski*, 12 Cal. Rptr. at 728.

[39] *See State Farm*, 8 Cal. Rptr. 3d at 69 (applying the IAD because the facts and circumstances did not implicate section 2115, but generally stating that California always has the right to use section 2115 as an exception to the IAD).

[40] *See id.* at 65.

[41] *See* Cal. Corp. Code § 2115.

[42] *See id.* The Legislative Committee Comment states that a corporation incorporated in another state is not required to comply with the General Corporation Law of California even if all of its shareholders reside in California and all of its business occurs within California. *Id.* legislative committee cmt. But it goes on to state that section 2115 does require a foreign corporation with specific minimum contacts in California to comply with certain provisions of the local law to protect California creditors and shareholders. *Id.*

[43] *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89–90 (1987); Shaffer v. Heitner, 433 U.S. 186, 215 n.44 (1977); McDermott Inc. v. Lewis, 531 A.2d 206, 215–16 (Del. 1987); *see also* Restatement (Second) of Conflict of Laws § 302 (1971).

[44] *See* Cal. Corp. Code § 2115; *State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 858.

[45] *See* Cal. Corp. Code § 2115; *Wilson*, 187 Cal. Rptr. at 858. Section 2115 generally regulates annual elections and removal of directors, director standards of care, limitations

To come under the purview of section 2115, a foreign corporation must meet two prerequisites.[46] First, it must transact more than one-half of its business in California.[47] "Business" is measured by the corporation's in-state property assets, sales revenue, and payroll allocations.[48] Second, more than one-half of the corporation's voting securities must be held by persons with record California addresses.[49]

The statute expressly exempts, however, any corporation with outstanding securities listed on a national securities exchange certified by the California Commissioner of Corporations.[50] This provision effectively limits the statute's reach to only nonpublic companies, because currently, the certified exchanges are the New York Stock Exchange ("NYSE"), American Stock Exchange ("AMEX"), and Nasdaq Stock Market ("NASDAQ").[51] A foreign corporation that satisfies these criteria, and is not exempt, has 135 days from the beginning of the following year to comply with California's standards of governance set forth in the Corporations Code.[52]

This provision operates in conjunction with several sections of the California Revenue and Taxation Code.[53] Regardless of the state of in-

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on corporate distributions, liability of shareholders, requirements for shareholder meetings, cumulative voting, limitations on mergers, conversions and reorganizations, dissenter's rights, and inspection rights of the Attorney General. CAL. CORP. CODE § 2115; *see VantagePoint*, 871 A.2d at 1114 n.22.

[46] *See* CAL. CORP. CODE § 2115.

[47] *See id.*

[48] *See id.* (referencing the applicable sections throughout the Code that explain the method for determining these factors). These three factors are defined by the California Revenue and Taxation Code. CAL. REV. & TAX. CODE §§ 25129, 25132, 25134 (West 2006). The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in California during the taxable year, and the denominator is the average value of all of the corporation's real and tangible personal property owned or rented and used during the taxable year. *Id.* § 25129. The payroll factor is a fraction, the numerator of which is the total amount of compensation paid by the corporation in California during the taxable year, and the denominator is the total compensation paid everywhere by the corporation during the taxable year. *Id.* § 25132. The sales factor is a fraction, the numerator of which is the corporation's total sales in California for the taxable year, and the denominator is the total sales of the corporation everywhere during the taxable year. *Id.* § 25134.

[49] *See* CAL. CORP. CODE § 2115.

[50] *See id.*

[51] *See id.*

[52] *See id.*

[53] *See id.*; CAL. REV. & TAX. CODE § 23151 (setting out general imposition of corporate franchise tax); *id.* § 25101 (stating factors in determining derivation of corporate income); *id.* § 25128 (stating apportionment of California business income relative to total corporate revenues); *id.* § 25129 (stating formula for determining California property factor); *id.* § 25132 (stating formula for determining California payroll factor); *id.* § 25134 (stating formula for determining California sales factor). Interestingly, section 2115 formerly operated in conjunction with California Corporations Code section 2108, which was repealed

corporation, section 23151 of this Code mandates that all corporations doing any business in California must pay an annual franchise tax to the state.[54] To calculate this tax, corporations must multiply their total revenue by a factor determined by the same figures used to measure business in section 2115: California property assets, sales revenue, and payroll allocations.[55] The California legislature purposely used these same figures in section 2115 for ease of determination and for the benefit of corporations.[56] Upon calculating and filing their annual franchise tax payments, corporations should immediately know if they meet one of the prerequisites of section 2115 and need to investigate whether they have to comply with the statute's regulations.[57]

If a foreign corporation qualifies for California regulation under section 2115, it has 135 days to do one of three things.[58] First, the corporation can reduce its business operations in California to avoid the additional layer of section 2115 regulation.[59] Second, the corporation can continue to take advantage of its California business operations and choose to comply with both section 2115 and the internal affairs regulations of its incorporating state.[60] Finally, the corporation could reincorporate in California to avoid potential regulatory conflicts with its current state of incorporation and extra state franchise taxes.[61]

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in 1997. *See* CAL. CORP. CODE § 2108 (repealed by 1997 Cal. Adv. Legis. Serv. 187 (Deering)). Section 2108 mandated that all corporations qualified to do business in California must file an annual statement regardless of state of incorporation. *See id.* This statement had to detail the percentage of the corporation's stockholders residing in California and the extent of all California-based revenue, property assets, and payroll allocations. *See id.* Therefore, upon filing its annual section 2108 statement, corporations immediately knew whether or not they would be subjected to the regulatory standards in section 2115. *See id.* The California legislature decided to eliminate the requirement to file this annual statement, however, and opted instead to incorporate the figures already used in calculating corporate franchise taxes for ease of determination by the corporations. *See id.* ch. 21 legislative committee cmt.

[54] CAL. REV. & TAX. CODE § 23151 (making exceptions to this general rule only for banks, financial institutions, and other corporations exempted from taxation under the California Constitution).

[55] *Id.* § 23128 (stating that business income shall be apportioned to California by multiplying the corporation's total business income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four); *see supra* note 48.

[56] *See* CAL. CORP. CODE ch. 21 legislative committee cmt.

[57] *See id.* § 2115.

[58] *See id.*

[59] *See id.*

[60] *See id.*

[61] *See* CAL. CORP. CODE § 2115.

B. *Public Policy Supporting Section 2115*

California's statute, giving it the right to regulate the internal affairs of foreign corporations, is neither a new idea nor unique to California.[62] The same idea is incorporated into the statutory and common law of other states as well.[63] For example, in the landmark New York Court of Appeals decision *German-American Coffee Co. v. Diehl* in 1915, Judge Cardozo stated that "when countless corporations, organized on paper in neighboring states, live and move and have their being in New York, a sound public policy demands that our Legislature be invested with this measure of control."[64] The policy behind California's section 2115 mirrors Cardozo's statement.[65] California's interest in protecting resident shareholders and stakeholders is greater than any incorporating state's right to regulate corporate internal affairs when the majority of the corporation's business is done inside of California.[66]

Prospective corporations can incorporate in any state of their choosing, regardless of any actual connection to that state.[67] There-

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[62] *See* N.Y. BUS. CORP. LAW §§ 1319–1320 (Consol. 2006); Weede v. Iowa S. Utils. of Del., 2 N.W.2d 372, 395 (Iowa 1942); German-Am. Coffee Co. v. Diehl, 109 N.E. 875, 875 (N.Y. 1915).

[63] *See* N.Y. BUS. CORP. LAW §§ 1319–1320; *Weede*, 2 N.W.2d at 395; *Diehl*, 109 N.E. at 875.

[64] 109 N.E. at 877. In this case, shareholders of German-American Coffee, a New Jersey corporation operating in New York, brought a derivative suit challenging the validity of certain dividend payments. *Id.* at 875. Both New York and New Jersey forbade the disputed dividend, but New Jersey law prohibited derivative actions, whereas New York law allowed them. *Id.* The court applied the local law of New York, overriding the traditional IAD, and permitted the suit. *See id.* at 877–78.

[65] *See* CAL. CORP. CODE § 2115 legislative committee cmt.; *Provident*, 159 P. at 156, 157; *Wilson*, 187 Cal. Rptr. at 857; *Sobieski*, 12 Cal. Rptr. at 728.

[66] *See Provident*, 159 P. at 156, 157; *Wilson*, 187 Cal. Rptr. at 857; *Sobieski*, 12 Cal. Rptr. at 728.

[67] *See* Kaplan, *supra* note 1, at 435; Subramanian, *supra* note 1, at 1802–03; Tung, *supra* note 1, at 44. For a discussion of economic and democratic arguments that question this general rule, see Greenfield, *supra* note 6, at 140–44. Delaware has proven to be far and away the most popular choice for corporations. *See id.* at 135 (stating that the reasons typically cited for Delaware's dominance in numbers of incorporating entities are the state's management-friendly corporate laws, the expertise of Delaware courts, and an abundance of strictly corporate precedent). This state has a population of less than *one-third of one percent* of the United States, but it is the state of incorporation for more than *fifty percent* of all public companies and more than *sixty percent* of the Fortune 500. *See id.* at 136; *see also* POPULATION DIVISION, U.S. CENSUS BUREAU, TABLE 1: ANNUAL ESTIMATES OF THE POPULATION FOR THE UNITED STATES, REGIONS, AND STATES AND FOR PUERTO RICO: APRIL 1, 2000 TO JULY 1, 2006, (2006), http://www.census.gov/popest/states/tables/NST-EST2006-01.xls (showing population statistics by state). Delaware's estimated population in 2006 was 853,000, while that of the United States was 300,000,000, which means that Delaware accounts for only 0.28% of the nation. *See* POPULATION DIVISION, U.S. CENSUS BUREAU, *supra*. Further, Delaware incorporation statistics demonstrate that of all of the companies incorporated there, very few of them actually have any connection with the state other

fore, corporations can choose which state will govern their internal affairs.[68] Conversely, employees, suppliers, and the communities that support those corporations do not usually live in the state of incorporation—they live in the states where the corporation actually operates.[69] Because they are not citizens of the state of incorporation, that state has no real incentive to protect them.[70] Thus, California's section 2115 seeks to protect these groups of people by preventing foreign corporations from relying on other states' laws while benefiting from California residents.[71]

C. *Judicial Interpretation*

Two California court decisions that predate section 2115 laid the groundwork for the statute's eventual operation and shed light on the California legislature's goal in enacting section 2115.[72] Three subsequent California court decisions govern the operation of the statute and establish the outer bounds of California's ability to regulate foreign corporations.[73] These decisions upheld the statute in the face of both constitutional and substantive challenges to its validity.[74] Thus, California courts have allowed California to side-step the traditional mandate of the IAD in favor of using local law to regulate corporate internal affairs.[75]

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than their charters and taxation obligations. *See Our Annual Ranking of America's Largest Corporations*, FORTUNE 500, Apr. 17, 2006, http://money.cnn.com/magazines/fortune/fortune500/states/D.html (illustrating that of all of the Fortune 500 companies chartered in Delaware, only DuPont is headquartered there); *The Largest Private Companies, supra* note 18 (illustrating that of all 394 privately held companies with revenue over $1 billion that are chartered in Delaware, only WL Gore & Associates is headquartered there).

[68] *See* Greenfield, *supra* note 6, at 136. Most corporations choose Delaware because its regulations are less stringent than those of other states like California in that they impose only the minimum requirements and duties upon corporate management. *See* State of Delaware Division of Corporations, *supra* note 18 (explaining why corporations choose to incorporate in Delaware); *see also* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (holding that the sole obligation of directors is to maximize the interests of the shareholders); Katz v. Oak Indus. Inc., 508 A.2d 873, 879 (Del. Ch. 1986) (holding that the obligation of directors is to maximize the long-run interests of the shareholders and that doing so "at the expense of others" is not a breach of duty).

[69] *See* Greenfield, *supra* note 6, at 140.

[70] *See id.* at 140–41.

[71] *See* CAL. CORP. CODE § 2115 (West 2006).

[72] *See Provident*, 159 P. at 156, 157; *Sobieski*, 12 Cal. Rptr. at 728.

[73] *See Friese*, 36 Cal. Rptr. 3d at 569; *State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 857.

[74] *See State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 856, 858, 861–62.

[75] *See Friese*, 36 Cal. Rptr. 3d at 569; *State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 857.

In doing so, however, the California courts did not totally turn a blind eye to the rationale behind the IAD, but rather merely worked within the narrow confines of section 2115 in situations where it should trump the IAD.[76] These courts determined that in those rare circumstances when a corporation meets the prerequisites of section 2115, California's need to protect its shareholders and stakeholders legitimizes its right to regulate foreign corporations.[77] The courts reasoned that the regulatory net in which California is attempting to catch corporations is appropriate because it is sufficiently small and easily determinable.[78] This means that due to section 2115's prerequisites that a corporation have significant contacts with the state and not be listed on national securities exchanges, there are relatively few foreign corporations that can be regulated, and all of them will have months of advance notice.[79] Therefore, although California has recognized the IAD as an acceptable method of determining which state should regulate corporate internal affairs in some situations, it has very clearly established section 2115 as a necessary exception to that rule.[80]

1. Decisions Prior to the Enactment of Section 2115

In 1916, in *Provident Gold Mining Co. v. Haynes*, the California Supreme Court extended a line of prior cases, including two from the U.S. Supreme Court, that allowed nonincorporating states to regulate foreign corporations.[81] These prior decisions were confined to situations where the corporations had expressly referenced a plan to conduct business in foreign states in their charters.[82] For example, in the 1901 case *Pinney v. Nelson*, a Colorado corporation expressly provided a clause in its charter that indicated its plans to extend business operations to California.[83] The U.S. Supreme Court rejected the corporation's argument that it could only be subject to Colorado internal affairs regulations under traditional application of the IAD because it obviously planned on moving some of its business ventures into Cali-

[76] *See State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 857.

[77] *See State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 857.

[78] *See Wilson*, 187 Cal. Rptr. at 860–61.

[79] *See* CAL. CORP. CODE § 2115 (West 2006).

[80] *See State Farm*, 8 Cal. Rptr. 3d at 69; *Wilson*, 187 Cal. Rptr. at 857.

[81] *See* 159 P. at 156, 157 (referencing Thomas v. Matthiessen, 232 U.S. 221, 232–35 (1914) and Pinney v. Nelson, 183 U.S. 144, 148–49 (1901)).

[82] *See Thomas*, 232 U.S. at 232–35; *Pinney*, 183 U.S. at 148–49; Peck v. Noee, 97 P. 865, 865–66 (Cal. 1908).

[83] 183 U.S. at 147.

fornia and should have planned on complying with California law in doing so.[84]

In *Provident*, the California Supreme Court went further and decided that a foreign corporation need not expressly acknowledge in its charter any intent to transact business in California to come under the state's regulatory scheme.[85] There, the plaintiff's claim involved the potential liability of shareholders, based on the decisions of the board of an Arizona corporation transacting significant amounts of business in California.[86] The court decided that California regulation was legitimate, even though the corporation was chartered in Arizona, because of the significant amount of business it conducted in California.[87] The court stated that holding otherwise would make it too easy for foreign corporations to take advantage of doing business in California while escaping California's standards of liability.[88]

Forty-five years later in 1961, in *Western Air Lines, Inc. v. Sobieski*, a California Court of Appeal relied on the same policy outlined in *Provident* to hold a Delaware corporation to California regulatory standards requiring cumulative voting.[89] The corporation was formerly chartered in California, but had reorganized and reincorporated to take advantage of the fact that Delaware did not require cumulative voting.[90] The court determined that California could force the Delaware corporation

[84] *See id.* at 149–51. The Court stated that when a corporation is formed in one state, but by the express terms of its charter is created for doing business in another state, and business is eventually done in that state, it must be assumed that the charter contract was made by reference to the laws of the state where business is done, and the liability that those laws impose will attend the transaction of such business. *Id.* at 151. In making the same point by reference to contract law, the Court went on to say that while making a contract, parties may consider some other law than that of the place of contracting, in which case the other law would control. *Id.* at 148. Finally, the Court drew from article XII, section 15 of the California Constitution in saying that "[n]o corporation organized outside the limits of this State shall be allowed to transact business within this State on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this State." *Id.* at 145.

[85] *See* 159 P. at 157.

[86] *See id.* at 156.

[87] *See id.* at 157.

[88] *See id.* The court explained that if it allowed the defendants' arguments, incorporators would be able to conduct business in California but escape the liabilities imposed by California law merely by using general language about their future business operations in their articles of incorporation. *See id.*

[89] *See Sobieski*, 12 Cal. Rptr. at 728.

[90] *See id.* at 720. The court decided that following Western's argument would be tantamount to saying that initially the California Corporations Commissioner has the power to require that certain rights be guaranteed to shareholders before permitting the sale of a foreign corporation's stock, but that immediately thereafter, by amending its charter in another state, a foreign corporation can completely circumvent the requirement to continue providing those rights. *Id.* at 728.

to have cumulative voting rights and thus declined to apply the IAD.[91] It concluded that California could, in effect, amend the charter of the foreign corporation because the corporation had purposefully evaded an element of shareholder protection that the state believed was vital.[92]

2. Decisions Following the Enactment of Section 2115

In 1982, a California Court of Appeal rendered a monumental decision in *Wilson v. Louisiana-Pacific Resources, Inc.*, where it forced a Utah corporation to alter its charter to provide for cumulative voting.[93] The court upheld section 2115 in the face of a constitutional challenge to its legitimacy and expressly stated that the IAD has never been blindly followed in California.[94] The court reasoned that because of both the significance of the contacts between the Utah corporation and California, and the lack of its actual business contacts with Utah, the IAD would not be invoked to apply Utah law.[95]

The court determined that because a corporation can only have the type of contacts mandated by section 2115 in one state at a time, there can be no risk of conflict with similar types of regulations in other states.[96] Even the worst-case scenario for a foreign corporation—having to comply with two layers of regulation imposed by its incorporating state and by California—was not burdensome enough to nullify section 2115.[97] Further, there was no suggestion or evidence that the statute was adopted for the purpose of deterring foreign cor-

[91] *See id.*

[92] *See id.*

[93] *See* 187 Cal. Rptr. at 863.

[94] *See id.* at 858, 863.

[95] *See id.* at 863. The court first reasoned that the statute did not offend the U.S. Constitution's Full Faith and Credit Clause because any interest that Utah had in maintaining a laissez-faire attitude through refusing to require cumulative voting was outweighed by California's policy supporting cumulative voting to protect citizen-shareholders in foreign corporations. *See id.* at 857. The court then determined that the statute did not offend the U.S. Constitution's Commerce Clause because it did not overburden interstate commerce. *See id.* at 859–60. Next, the court decided that there was no violation of the U.S. Constitution's Due Process principles because California had the greatest interest in regulating cumulative voting of corporations whose stock is held by a majority of its residents, and section 2115 was a rational response to this interest. *See id.* at 861. Finally, the court held that the statute did not offend the U.S. Constitution's Equal Protection Clause by excluding only corporations listed on certified securities exchanges. *See id.* at 862–63. It was rational for the California legislature to believe that the disclosure requirements and other forms of regulation imposed by the NYSE, AMEX, and NASDAQ, combined with the higher degree of scrutiny to which the corporations are subjected in the marketplace, provided an adequate substitute for the regulations imposed by section 2115. *See id.* at 863.

[96] *See id.* at 860.

[97] *See id.*

porations from doing business in California, nor that it would have any such effect in the future.[98] The court held that California had the greatest interest in regulating corporations where its residents hold the majority of stock because the state could suffer severe social costs if foreign corporations could ignore its public policies.[99] Therefore, the court determined that section 2115 was a valid exception to the IAD and should be utilized as such.[100]

More recently, in the 2005 case of *Friese v. Superior Court of San Diego County*, another California Court of Appeal reasserted the state's ability to regulate the internal affairs of a foreign corporation.[101] In this case, the California bankruptcy trustee of a defunct Delaware corporation sued its former officers and directors for insider trading.[102] The conflict here was not based on section 2115, but regardless, the court stated that in some situations, a California court could, in the interest of justice, take jurisdiction over the internal affairs of a foreign corporation and apply local law.[103] The court highlighted the fact that the *Restatement (Second) of Conflict of Laws* seems to have accepted California's statute as an exception to the traditional application of the IAD by using *Sobieski* and *Wilson* in illustrative comments and notes following its discussion of internal affairs regulation.[104]

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[98] *See Wilson*, 187 Cal. Rptr. at 859.

[99] *See id.* at 861.

[100] *See id.* at 862.

[101] *See* 36 Cal. Rptr. 3d at 569.

[102] *See id.* The dispute in this case did not concern California's section 2115, but rather section 2116, which states that a director's liability to a corporation is a matter of internal affairs and should be governed by the laws of the state in which it is incorporated. *Id.* at 559. The defendant directors attempted to use this as a defense to being sued under California law because the corporation was chartered in Delaware. *Id.* at 561. The court, however, decided that even though the California statute codified the IAD for insider trading liability, another California securities fraud statute could trump the IAD. *See id.* at 570. The court stated that the IAD did not prevent the local claims against the directors because of the California legislature's "historic and well-established intent" to regulate activities taking place in California, even when it is not the state of incorporation. *See id.*

[103] *See id.* at 569 ("'In some situations . . . the local court may, in the interest of justice, take jurisdiction over internal affairs and apply local law. A typical example is the application of the Corporate Securities [Law of 1968] to protect California residents against fraud in the sale of securities of a foreign corporation.'" (quoting 9 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW § 239 (10th ed. 2005))).

[104] *See id.* at 568; RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 302 cmt. g, 304, 309 (1971). Sections 302, 304, and 309 contain clauses stating that usually the local law of the state of incorporation will be applied to determine internal affairs issues. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 302, 304, 309 (1971). The exception to this occurs only 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 case the local law of the other state will be applied. *See id.*

The courts' application of section 2115 has not been unwavering, however.[105] For example, in the 2003 case of *State Farm Mutual Automobile Insurance Co. v. Superior Court of Los Angeles County*, a California Court of Appeal chose not to apply section 2115 and instead opted for the traditional application of the IAD.[106] In this case, insurance policy holders in California alleged a breach of duty by the directors of State Farm, an Illinois corporation, for not providing a dividend and amassing massive amounts of cash surplus instead.[107] The court decided that, because of the existence of multistate and multinational organizations, directors and officers have a significant right to know what law will be applied to their actions at all times.[108] In certain situations, the court concluded that section 2115 could cause too much uncertainty.[109]

In supporting its holding, the court actually asserted one of the major policy justifications behind the IAD—that it provides certainty to corporations regarding which law will be applied to their actions—and even cited one of Delaware's major cases in great length.[110] The court applied Illinois law to the dispute instead of the California regulations from section 2115.[111] Despite utilizing the IAD, however, the court reaffirmed section 2115 by stating that California retained the right to govern the internal affairs of foreign corporations when the prerequisites of the statute were met.[112] Moreover, the court held that in other factual situations, California was even within its rights to regulate dividend distributions.[113]

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[105] *See State Farm*, 8 Cal. Rptr. 3d at 63, 67.

[106] *See id.*

[107] *See id.* at 60.

[108] *See id.* at 65 (quoting *McDermott*, 531 A.2d at 216–17).

[109] *See id.* (quoting *McDermott*, 531 A.2d at 216–17).

[110] *See State Farm*, 8 Cal. Rptr. 3d at 65 (quoting *McDermott*, 531 A.2d at 215–16). The *McDermott* court explained that the policy behind the IAD: (1) serves the need for a single, constant, and equal law for corporations to avoid the fragmentation of interdependent internal relationships; (2) facilitates planning and enhances predictability; (3) satisfies the right of corporate directors and officers to know what law will be applied to their actions ahead of time; and (4) satisfies the right of corporate stockholders to know by what standards of accountability they may hold those managing the corporation's business and affairs. 531 A.2d at 215–16.

[111] *See State Farm*, 8 Cal. Rptr. 3d at 69.

[112] *See id.*

[113] *See id.*

II. Regulation of Foreign Corporations and Recognition of California Policy in Other Jurisdictions and the *Restatement*

Several courts in jurisdictions other than California have endorsed the same policy that drives section 2115 of the California Corporations Code.[114] They too have chosen to utilize local law rather than the IAD in resolving corporate disputes regarding internal affairs.[115] New York, for example, has enacted regulations for foreign corporations that have language similar to California's section 2115, and the New York courts have enforced them.[116] Although federal case law discussing the IAD is sparse, jurisdictions such the U.S. Court of Appeals for the Second Circuit and two U.S. District Courts for New York and Massachusetts have refused to apply the IAD automatically.[117] Further, a case from the Supreme Court of Iowa also demonstrates that California's regulation of foreign corporations is neither an extreme nor novel measure and is, in fact, replicated elsewhere.[118] Lastly, the Restatement (Second) of Conflict of Laws has adopted the California exception to the IAD and even uses California case law in explaining it.[119]

A. *Federal Cases in Support of California Public Policy*

The New York state legislature has enacted a series of statutes similar to section 2115 of the California Corporations Code and its progeny.[120] Under New York's regulatory scheme, substantially the same regulations are applied to in-state corporations that are applied to foreign corporations generating more than one-half of their business income in New York for three consecutive years.[121] Two federal courts

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[114] *See, e.g.*, Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 261 (2d Cir. 1984); Stephens v. Nat'l Distillers & Chem. Corp., No. 91-CIV-2901, 1996 WL 271789, at *4–5 (S.D.N.Y. May 21, 1996); Resolution Trust Corp. v. Gladstone, 895 F. Supp. 356, 363 (D. Mass. 1995); Weede v. Iowa S. Utils. of Del., 2 N.W.3d 372, 395 (Iowa 1942); Greenspun v. Lindley, 330 N.E.2d 79, 81 (N.Y. 1975).

[115] *See, e.g.*, *Norlin*, 744 F.2d at 261; *Stephens*, 1996 WL 271789, at *4–5; *Gladstone*, 895 F. Supp. at 363; *Weede*, 2 N.W.3d at 395; *Greenspun*, 330 N.E.2d at 81.

[116] *See* Drenis v. Haligiannes, No. 04-CIV-9263, 2006 WL 2720971, at *6 (S.D.N.Y. Sept. 25, 2006); *Stephens*, 1996 WL 271789, at *4–5; *Greenspun*, 330 N.E.2d at 477–78. *Compare* N.Y. Bus. Corp. Law §§ 1319–1320 (Consol. 2006), *with* Cal. Corp. Code § 2115 (West 2006).

[117] *Norlin*, 744 F.2d at 261; *Stephens*, 1996 WL 271789, at *4–5; *Gladstone*, 895 F. Supp. at 363.

[118] *See Weede*, 2 N.W.3d at 395.

[119] *See* Restatement (Second) of Conflict of Laws § 302 cmt. g (1971).

[120] *See* N.Y. Bus. Corp. Law §§ 1319–1320.

[121] *Compare* N.Y. Bus. Corp. Law §§ 1319–1320, *with* Cal. Corp. Code § 2115.

interpreting New York law have interpreted these statutes—New York Business Corporation Law sections 1319 and 1320—and allowed the state to reject the IAD in favor of local New York law.[122]

In 1984, in *Norlin Corp. v. Rooney, Pace Inc.*, the U.S. Court of Appeals for the Second Circuit decided that application of the IAD is not mandatory.[123] The court expressly stated that because the New York legislature had decided to apply certain provisions of the state's business law to any corporation doing business in the state, regardless of its state of incorporation, courts did not have to apply the IAD.[124] Therefore, the court interpreted New York Business Corporation Law to provide that any foreign corporation operating sufficiently within New York can be subjected to the state's law governing corporate internal affairs.[125]

A U.S. District Court for the Southern District of New York similarly interpreted New York law in an internal affairs dispute involving a Kentucky corporation.[126] In 1996, in *Stephens v. National Distillers & Chemical Corp.*, the court held that the public policy concerns of New York mandated a departure from the IAD.[127] The court applied New York law to the exclusion of the law of Kentucky, the state of incorporation, and noted that a condition on the right to do business in New York was yielding obedience to its laws concerning corporate internal affairs.[128]

Further, in *Resolution Trust Corp. v. Gladstone* in 1995, the U.S. District Court for Massachusetts even went so far as to formulate a standard with which a party trying to enforce nonincorporating state laws in internal affairs litigation can overcome the presumption associated with the IAD.[129] The court stated that the IAD does not have to be the default rule when certain circumstances are met.[130] Those circumstances are: (1) where the expectations of the parties merit the application of other law, (2) where local law should be applied in the name of certainty, or (3) where the ease in the determination and application of the law to be applied justifies the use of another jurisdiction's law.[131]

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[122] *See Norlin*, 744 F.2d at 261; *Greenspun*, 330 N.E.2d at 477–78.

[123] *See* 744 F.2d at 261, 263.

[124] *See id.* at 261.

[125] *See id.*

[126] *See Stephens*, 1996 WL 271789, at *4.

[127] *See id.*

[128] *See id.* at *4–5.

[129] *See* 895 F. Supp. at 363.

[130] *See id.*

[131] *See id.*

B. *State Cases in Support of California Public Policy*

In 1975, in *Greenspun v. Lindley*, the Court of Appeals of New York expressly rejected automatic application of the IAD.[132] The court decided to apply Massachusetts law to a dispute regarding the investment policies and board behavior of an investment trust chartered in Massachusetts.[133] The court only applied the law of the state of incorporation, however, because there was no proof that the investment trust had significant business contacts in New York.[134] The court stated that had there been a showing that the Massachusetts investment trust was "present" in the state of New York, the court would have been free to apply New York law, regardless of the state of incorporation and the IAD.[135] Thus, the New York court used the same reasoning as the courts in California to justify maintaining an exception to the IAD for corporations operating significantly within a state's boundaries.[136]

The Supreme Court of Iowa also took issue with the IAD and declined to apply it in *Weede v. Iowa Southern Utilities Co. of Delaware* in 1942.[137] In this case, Iowa Southern was incorporated in Delaware, but its principal place of business was in Iowa, where all of its property was located, and all of its officers, directors, and shareholders resided.[138] The court stated that the corporation's foreign identity, based on its state of incorporation, was "at best a metaphysical concept" and was not applicable to the resolution of the conflict-of-laws analysis due to the "practical necessities of the modern business world."[139] Because the corporation was far too invested in Iowa to circumvent its laws and regulations by incorporating elsewhere, the court applied Iowa law.[140] The *Weede* court concluded that incorporation in Delaware, by itself,

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[132] *See* 330 N.E.2d at 81.

[133] *See id.* at 80.

[134] *See id.* at 81.

[135] *See id.*

[136] *Compare Greenspun*, 330 N.E.2d at 80–81, *with* Provident Gold Mining Co. v. Haynes, 159 P. 155, 156, 157 (Cal. 1916), *and* Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 861 (Ct. App. 1983), *and* W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 728–29 (Ct. App. 1961).

[137] *See* 2 N.W.2d at 395. At issue in this case was the "sale" of a large portion of the corporate assets to a third party, but with no record of any actual sale or payment, which was a violation of Iowa corporate law and considered a sham transaction. *See id.* at 377. The court first decided that this was rightfully a matter of corporate internal affairs and then rejected the defendant's argument that Delaware law should apply because of the IAD. *See id.* at 395. The court concluded that it was free to pass judgment on issues involving the internal affairs of a foreign corporation and to force it to abide by local law. *See id.*

[138] *Id.* at 376–77.

[139] *Id.* (quoting Scholl v. Allen, 36 S.W.2d 353, 358 (Ky. 1931)).

[140] *See id.* at 395.

does not require Iowa to allow a corporation to transact business in Iowa unconditionally.[141]

C. Restatement (Second) of Conflict of Laws *in Support of California Public Policy*

Although it serves only as persuasive authority, the *Restatement (Second) of Conflict of Laws* expressly acknowledges the IAD, and courts around the country frequently cite to it.[142] These judicial opinions typically cite to the Restatement for its definition of the IAD and its explanation of the IAD's application and exceptions.[143] For example, section 302 states that matters involving the internal affairs of a corporation, defined as "the relations *inter se* of the corporation, its shareholders, directors, officers or agents," should be determined by the law of the state of incorporation.[144] The comments to this section of the Restatement explain that this rule is generally supported by the need for predictability and uniformity of result, protection of the justified expectations of the parties, implementation of the relevant policies of the state with the dominant interest in the decision of the particular issue, and ease in the application of the law to be applied.[145]

Along with generally explaining the IAD, however, the Restatement also describes situations in which the IAD is not an absolute rule and should not be applied.[146] Part two of the text of section 302 explains that where a nonincorporating state has a more significant relationship with the parties and issues involved in a dispute, the law of that state should be applied to the exclusion of the incorporating state's law.[147] The comments to this section elaborate on this exception and point out that, although such a situation may be rare, application of the IAD also should be prohibited when another state's interest overrides those of the incorporating state.[148]

Comment g to section 302 sets forth several factors to consider in determining which state's interests are most prevalent to an internal

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[141] *See id.*

[142] Restatement (Second) of Conflict of Laws § 302 (1971); *see* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1986); Edgar v. MITE Corp., 457 U.S. 624, 645 (1981); *Norlin*, 744 F.2d at 263; Friese v. Super. Ct. of San Diego, 36 Cal. Rptr. 3d 558, 568 (Ct. App. 2005); McDermott Inc. v. Lewis, 531 A.2d 206, 214 (Del. 1987).

[143] *See CTS Corp.*, 481 U.S. at 89; *MITE*, 457 U.S. at 645; *Norlin*, 744 F.2d at 263; *Friese*, 36 Cal. Rptr. 3d at 568; *McDermott*, 531 A.2d at 214.

[144] Restatement (Second) of Conflict of Laws § 302 cmt. a (1971).

[145] *See id.* cmt. b.

[146] *See id.* cmt. g.

[147] *Id.*

[148] *Id.*

affairs dispute.[149] Among these factors are the nature and extent of the corporation's relationship to the state of incorporation versus the nature and extent of the corporation's relationship to the state whose local law is sought to be applied.[150] This comment explains that the reasons for applying the law of the incorporating state become much less significant when a corporation has little or no contact with the state other than being incorporated there.[151] In these situations, comment g maintains that some other state will almost surely have a greater interest than the state of incorporation in the determination of any particular issue.[152] Further, this comment also makes clear that local state law, rather than the incorporating state's law, should be applied when the relevant local laws embody important policy decisions of the nonincorporating state.[153]

III. The Internal Affairs Doctrine in Delaware

In contrast to the approach applied by other states and recognized by the Restatement, Delaware acknowledges no exceptions to the IAD.[154] Delaware courts have interpreted the IAD to provide a categorical rule for resolving disputes involving corporate internal affairs.[155] The broad range of internal affairs that therefore cannot be governed by a foreign state are described generally as the adoption of bylaws; the issuance, reclassification, and repurchase of corporate stock; the holding of directors' and shareholders' meetings; the declaration and payment of dividends and other distributions; charter amendments; mergers; consolidations; and reorganizations.[156] A Delaware court has never permitted a foreign state to regulate any of these elements of the internal affairs of a corporation not chartered within that state.[157]

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[149] Restatement (Second) of Conflict of Laws § 302 cmt. g (1971).

[150] *Id.*

[151] *Id.*

[152] *See id.*

[153] *See id.*

[154] *See* VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1112–13, 1115 (Del. 2005); McDermott Inc. v. Lewis, 531 A.2d 206, 214–15 (Del. 1987).

[155] *See McDermott*, 531 A.2d at 214–15. *But see VantagePoint*, 871 A.2d at 1113 (allowing for one small caveat to the absolute rule of the IAD in Delaware, which has never been invoked, by explaining that the only situation in which the IAD would not apply would be where the "law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce").

[156] *See* State Farm Mut. Auto Ins. Co. v. Super. Ct. of L.A. County, 8 Cal. Rptr. 3d 56, 64 (Ct. App. 2003).

[157] *See VantagePoint*, 871 A.2d at 1112–13, 1115; *McDermott*, 531 A.2d at 214–15.

A. *Delaware Policy Supporting Absolute Use of the IAD*

Delaware courts rely on three traditional policy justifications to support the practice of using the IAD as a categorical rule: (1) allowing only the incorporating state to regulate internal affairs provides predictable results; (2) allowing a nonincorporating state to regulate foreign corporations would violate the Commerce Clause of the U.S. Constitution; and (3) allowing a nonincorporating state to regulate foreign corporations would violate the Due Process Clause of the U.S. Constitution.[158]

1. Allowing Only the Incorporating State to Regulate Internal Affairs Provides Predictable Results

Proponents of the IAD argue that the original organizers of a corporation and its subsequent participants need to know the standards that will be applied to the corporation in the future so that they can plan current transactions under fixed procedures that will determine their rights and liabilities.[159] The idea is that a rule mandating that the state of incorporation has the sole right to regulate the corporation throughout its existence protects the justified expectations of the organizing parties and guarantees that the rights they originally negotiated for will remain intact.[160] When a corporation is formed, corporate organizers contract with each other to create their business.[161] Organizers make an affirmative choice regarding which set of state regulations to utilize, and that chosen set of regulations should not be altered without their action to reincorporate somewhere else.[162]

Moreover, although corporate organizers have the ability to choose the state of incorporation at the time of creation, unconsidered or unforeseen factors may later affect where business is physically conducted.[163] For example, changing market demands may encour-

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[158] *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89–90 (1986); *VantagePoint*, 871 A.2d at 1113, 1114–15; *McDermott*, 531 A.2d at 215–16; *see also* David M. Majchrzak, Note, *Corporate Chaos: Who Should Govern Internal Affairs?*, 24 T. JEFFERSON L. REV. 83, 86 (2001).

[159] *See CTS Corp.*, 481 U.S. at 89–90; Majchrzak, *supra* note 158, at 86.

[160] *See VantagePoint*, 871 A.2d at 1113; *McDermott*, 531 A.2d at 216.

[161] *See* Majchrzak, *supra* note 158, at 88.

[162] *Id.* at 88; *see CTS Corp.*, 481 U.S. at 89–90; *see also* W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 728 (Ct. App. 1961) (describing how a corporation actually decided to reincorporate in another state to gain the benefits of a different set of state regulations governing corporate internal affairs).

[163] Majchrzak, *supra* note 158, at 88, *see CTS Corp.*, 481 U.S. at 90; *VantagePoint*, 871 A.2d at 1112–13; *McDermott*, 531 A.2d at 216.

age a corporation to move to new states.[164] In a more extreme case, a corporation may be forced to move to new states just to survive, as in the case of a corporation that must locate closer to suppliers or natural resources to save money on transporting materials or goods.[165] Therefore, by providing predictability, the IAD operates to prevent a corporation in this situation from being subjected to multiple and possibly inconsistent legal standards as a result of reasons largely beyond its control.[166]

2. Allowing a Nonincorporating State to Regulate Foreign Corporations Violates the Commerce Clause

The U.S. Constitution's Commerce Clause traditionally permits only incidental regulation of interstate commerce by the states; direct regulation is prohibited.[167] State statutes are generally upheld under the Commerce Clause if they regulate "even-handedly to effectuate a legitimate local public interest" and if their effects on interstate commerce are only incidental, *unless* "the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[168]

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[164] Majchrzak, *supra* note 158, at 88, *see CTS Corp.*, 481 U.S. at 90; *VantagePoint*, 871 A.2d at 1112–13; *McDermott*, 531 A.2d at 216.

[165] *See* Majchrzak, *supra* note 158, at 88.

[166] *See CTS Corp.*, 481 U.S. at 90; *VantagePoint*, 871 A.2d at 1112–13; Majchrzak, *supra* note 158, at 88.

[167] *See* Edgar v. MITE Corp., 457 U.S. 624, 640 (1981) (citing Shafer v. Farmers Grain Co. of Embden, 268 U.S. 189, 199 (1925)); Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (citing Huron Portland Cement Co. v. Detroit, 362 U.S. 440, 443 (1960)).

[168] *Pike*, 397 U.S. at 142. The Commerce Clause, as defined in Article I, Section 8 of the U.S. Constitution, gives Congress the power to legislate on matters involving interstate commerce. *See* U.S. CONST. art. I, § 8. This power allows Congress to preempt state or local regulation of such commerce. *See* Houston, E. & W. Tex. Ry. Co. v. United States, 234 U.S. 342, 351–52 (1914) (upholding the ability of the Interstate Commerce Commission to set intrastate railroad rates to the exclusion of the locally determined rates because of their direct impact on interstate commerce); McDermott v. Wisconsin, 228 U.S. 115, 132, 133–34 (1913) (requiring more accurate retail labeling on items traveling in interstate commerce than was required locally); Hipolite Egg Co. v. United States, 220 U.S. 45, 51, 57–58 (1911) (allowing Congress to prohibit the sale of impure or adulterated food or drugs regardless of local screening procedures).

More importantly to this Note, however, the Commerce Clause has also been interpreted to ban any state and local law or regulation that places an undue burden on interstate commerce, even in the absence of specific congressional action. *See* Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520, 529–30 (1959) (holding that the Commerce Clause provides an independent limit on state or local power, even where Congress has not acted, when such power is used to overburden interstate commerce); S. Pac. Co. v. Arizona, 325 U.S. 761, 783–84 (1944) (holding that the Commerce Clause provides an independent limit on state or local power, even where Congress has not acted, when such power is used to overburden interstate commerce). This limiting function of the Commerce Clause, known as the "Dormant Commerce Clause," is relevant because the Delaware courts have

Further, the U.S. Supreme Court has invalidated state regulations that unreasonably interfere with interstate commerce relative to the state interests and policies behind them.[169] The Delaware courts have ruled that section 2115 of the California Corporations Code unreasonably burdens interstate commerce because it discourages corporations from doing business in California out of fear of the possibility of being regulated in a way that their states of incorporation do not mandate.[170]

The Supreme Court of Delaware has held that nonincorporating states have no, or at least very little, interest in regulating the internal affairs of foreign corporations, as compared to the interests of the actual incorporating state.[171] Because of this assumption, under Delaware's conception of the Commerce Clause, no such state can ever add an additional layer of internal affairs regulation.[172] The Supreme Court of Delaware has stated that the application of the IAD is therefore mandated by constitutional principles, except in the rarest situations, such as where the law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce.[173]

3. Allowing a Nonincorporating State to Regulate Foreign Corporations Violates the Due Process Clause

The final justification supporting Delaware's use of the IAD as a categorical rule is that a statute such as California's section 2115 violates principles of Due Process found in the Fifth and Fourteenth Amendments to the U.S. Constitution.[174] The Supreme Court of

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determined that section 2115 of the California Corporations Code should be held invalid because it overburdens interstate commerce and nonincorporating states have no sufficient interest to overcome such a burden. *See VantagePoint*, 871 A.2d at 1113.

[169] *See Bibb*, 359 U.S. at 529–30; *S. Pac. Co.*, 325 U.S. at 783–84.

[170] *See VantagePoint*, 871 A.2d at 1113–14. *But see Wilson*, 187 Cal. Rptr. at 859–60 (stating that there is no suggestion or evidence that section 2115 was adopted for the purpose of deterring foreign corporations from doing business in California nor that it has had or will have such an effect).

[171] *See VantagePoint*, 871 A.2d at 1113 (stating no criteria or reasoning for this proposition).

[172] *See id. But see* Oldham, *supra* note 4, at 121–23. Oldham disagrees with the Delaware court and thinks it is "doubtful that section 2115 could be successfully challenged as an excessive burden upon interstate commerce." *See id.* Instead, he believes that "California could not promote its substantial state interest embodied in section 2115 in another manner which would have a lesser impact on interstate activities." *Id.* Further, "[s]ince the local benefits which will flow from section 2115 are substantial and since one of its purposes is to protect California shareholders and creditors from fraud, it is highly doubtful that a court will find that section 2115 violates the commerce clause." *Id.*

[173] *See VantagePoint*, 871 A.2d at 1113.

[174] *See id.* at 1113; *McDermott*, 531 A.2d at 216. The Fifth and Fourteenth Amendments to the U.S. Constitution provide, respectively, that neither the United States nor any state

Delaware has determined that allowing a nonincorporating state to regulate the internal affairs of foreign corporations presents an "intolerable consequence to the corporate enterprise and its managers."[175] It has reasoned that when a corporation begins to operate in many different states and locales, its officers and directors have a right to know at all times exactly what law will be applied to their actions.[176]

Further, shareholders also have a right to know what standards of accountability they may use to hold corporate officers and directors liable for economic mishaps, bad internal governance, and gross negligence.[177] By investing in a corporation, shareholders are selecting the laws of a given state—the state of incorporation—to regulate the affairs of a corporation and to protect them if such a need arises.[178] If a corporation expands into other states and becomes subject to different and possibly conflicting regulations, the shareholders, officers, and directors are forced to deal with new rules they did not have the right to bargain and plan for, which offends notions of Due Process.[179] Delaware courts have refused to exalt the local interests of nonincorporating states over these constitutional concerns.[180]

B. *Judicial Interpretation of the IAD in Delaware*

McDermott Inc. v. Lewis is the leading Delaware case that establishes the absolute rule of the IAD and illustrates the sum of the state's policy goals.[181] In this case, decided in 1987, the Supreme

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governments shall deprive any person of "life, liberty, or property without due process of law." *See* U.S. CONST. amends. V, XIV. In both Amendments, this provision is known as the "Due Process Clause." *See id.* The Supreme Court has interpreted these clauses to protect the rights of individuals to contract and to engage in the common occupations of life, among many other rights. *See* Bd. of Regents of State Colls. v. Roth, 408 U.S. 564, 572 (1972) (enumerating a much longer list of protected rights).

The Delaware courts have invoked these principles of Due Process in the IAD debate to imply that section 2115 of the California Corporations Code takes these rights away from corporate organizers and shareholders by imposing extraneous regulations not bargained for at the time of incorporation. *See VantagePoint*, 871 A.2d at 1113; *McDermott*, 531 A.2d at 216. The argument is that a corporation should not have to give up the protection of the laws of the state of its own choosing—the state of incorporation—and be forced to comply with internal affairs laws of another state just because it increases its operations to more than fifty percent in that state. *See VantagePoint*, 871 A.2d at 1113; *McDermott*, 531 A.2d at 216.

[175] *McDermott*, 531 A.2d at 216.

[176] *See VantagePoint*, 871 A.2d at 1113; *McDermott*, 531 A.2d at 216–17.

[177] *See VantagePoint*, 871 A.2d at 1113; *McDermott*, 531 A.2d at 216–17.

[178] *See McDermott*, 531 A.2d at 216–17.

[179] *See id.*

[180] *See VantagePoint*, 871 A.2d at 1113; *McDermott*, 531 A.2d at 219.

[181] *See* 531 A.2d at 216.

Court of Delaware refused to interfere with the internal affairs of a Panamanian corporation and did not hesitate to apply the IAD, even though Panamanian corporate law completely contradicted that of Delaware.[182] Delaware law prohibits a subsidiary corporation from voting any shares held by the subsidiary's parent in favor of the parent in a given transaction, but Panamanian law allows it.[183] Delaware shareholders of the Panamanian subsidiary sued to enjoin such voting as a violation of Delaware law.[184] Nonetheless, the court decided that it was inappropriate for the state law of Delaware to interfere with the Panamanian corporation's voting because it was incorporated in Panama, not Delaware.[185]

The court determined that the subsidiary corporation was lawfully incorporated in Panama, and that Panama had a substantial interest in the internal affairs of its corporations and strong policy goals behind its governing regulations.[186] Delaware, on the other hand, had no real interest in the corporation and had no relationship with it other than the fact that shareholders of its subsidiary lived in Delaware.[187] Interestingly, the court never discussed the possibility of having to sort through any international law issues in adjudicating a dispute involving an internationally chartered corporation.[188]

The court concluded that Delaware's interference with the Panamanian corporation would have violated the Commerce Clause because Delaware had no justification beyond a suit on behalf of its citizens, and this could not outweigh any Panamanian interests.[189] The court stated that application of any rule other than the IAD would be 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."[190] Therefore, the court held that

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[182] *See id.* at 208–09.

[183] *See id.*

[184] *See id.*

[185] *See id.* Surprisingly, the court based its entire opinion on the IAD and did not mention the fact that international law may have been implicated by adjudicating an issue involving a corporation chartered outside of the United States. *See id.*

[186] *See McDermott*, 531 A.2d at 218–19.

[187] *See id.* at 218.

[188] *See id.* at 206–19.

[189] *See id.* at 216. The court explained that for Delaware to interfere in the internal affairs of a foreign corporation, having no relationship with it whatsoever, would clearly imply that the Panamanian corporation may be subject to the differing laws of all fifty states on various matters respecting its internal affairs. *Id.* It determined that "[s]uch a prohibitive burden has obvious commerce clause implications, and could not pass constitutional muster." *Id.* at 219.

[190] *Id.* at 216.

the IAD categorically requires the law of the state of incorporation to determine issues relating to corporate internal affairs.[191]

In reaching this conclusion, the Supreme Court of Delaware partially relied upon *CTS Corp. v. Dynamics Corp. of America,* which at the time was a very recently decided U.S. Supreme Court case.[192] *CTS Corp.* involved a Commerce Clause challenge to an Indiana corporate antitakeover statute that made it difficult for an out-of-state raider to take over an Indiana corporation.[193] The U.S. Supreme Court ruled that the statute was constitutional.[194] It held that a state did not violate the Commerce Clause, "notwithstanding heavy burdens imposed upon interstate commerce, if a state is merely regulating the internal affairs of its own corporations."[195]

Thus, although the Indiana statute probably made it less likely that an out-of-state raider would be interested in an Indiana corporation because of additional in-state takeover requirements, the statute was appropriate because it only actually governed the in-state target corporations.[196] The Supreme Court of Delaware wrote in its *McDermott* opinion that it interpreted *CTS Corp.* to provide strong support for a conclusion that the Commerce Clause actually mandates that a state apply the IAD to disputes involving foreign corporations.[197]

IV. *VantagePoint Venture Partners 1996 v. Examen, Inc.*: The Crux of the Battle Between California and Delaware to Regulate Foreign Corporations

In 2005, the Supreme Court of Delaware was faced with the decision of whether to uphold the IAD as a categorical rule in internal affairs disputes or recognize section 2115 of the California Corporations Code as a valid exception to that rule.[198] In *VantagePoint Venture Partners 1996 v. Examen, Inc.*, the court opted to maintain the status quo and refused to accept any arguments in favor of California's regulation of foreign corporations.[199] Despite Delaware's ruling in *Van-*

[191] *See McDermott,* 531 A.2d at 215.

[192] *See id.* at 217 (citing *CTS Corp.*, 481 U.S. at 69). *CTS Corp.* was decided on April 27, 1987, while *McDermott* was decided five months later on September 16, 1987. *See CTS Corp.*, 481 U.S. at 69; *McDermott*, 531 A.2d at 206.

[193] *See CTS Corp.*, 481 U.S. at 69.

[194] *See id.* at 94.

[195] *McDermott,* 531 A.2d at 217 n.12 (citing *CTS Corp.*, 481 U.S. at 69).

[196] *See CTS Corp.*, 481 U.S. at 94.

[197] *See McDermott,* 531 A.2d at 217 n.12 (citing *CTS Corp.*, 481 U.S. at 69).

[198] *See* VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1109–10 (Del. 2005).

[199] *See id.* at 1116.

tagePoint, however, California still maintains that it has the right to regulate foreign corporations.[200] Therefore, the outcome of any internal affairs litigation involving a Delaware corporation that falls under section 2115's purview seems to be completely dependent on where a plaintiff files the lawsuit.[201] This uncertainty leaves numerous private companies, many of which are large Fortune-500-type organizations, incorporated in Delaware but doing business in California on shaky legal ground when faced with the opportunity to increase operations in California.[202]

A. *Facts and Procedural Background*

On March 3, 2005, Examen, a Delaware corporation, filed a complaint in Delaware seeking a judicial declaration that VantagePoint, a Delaware limited partnership, was not entitled to a class vote of Examen's preferred stock regarding a proposed merger between Examen and Reed Elsevier.[203] VantagePoint was a majority shareholder of the preferred class of Examen's stock, but it was not an aggregate majority shareholder of all of the classes of stock combined.[204] VantagePoint would not have been able to block the merger unless there were a class vote.[205] On March 8, 2005, VantagePoint filed an opposing action in California.[206] This action sought a judicial declaration that Examen was a qualified "quasi-foreign" corporation under

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[200] *See* Friese v. Super. Ct. of San Diego, 36 Cal. Rptr. 3d 558, 569 (Ct. App. 2005) (explaining when a California court may take jurisdiction over internal affairs and apply local law to the exclusion of that of the state of incorporation).

[201] *Compare VantagePoint*, 871 A.2d at 1113–15 (upholding the use of the IAD as a categorical rule in Delaware), *and* McDermott Inc. v. Lewis, 531 A.2d 206, 215 (Del. 1987) (same), *with* Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 862–63 (Ct. App. 1983) (using section 2115 as an exception to the IAD and applying California law to the exclusion of the law of the state of incorporation). Cases in Delaware are being adjudicated by using the IAD as a categorical rule, while cases in California are being adjudicated by allowing section 2115 as a rare exception to the IAD. *See VantagePoint*, 871 A.2d at 1113–15; *McDermott*, 531 A.2d at 215; *Wilson*, 187 Cal. Rptr. at 862–63.

[202] *Compare Our Annual Ranking of America's Largest Corporations*, *supra* note 18, *with The Largest Private Companies*, *supra* note 18. Approximately eleven percent of all Fortune 500 corporations are private. *See Our Annual Ranking of America's Largest Corporations*, *supra* note 18; *The Largest Private Companies*, *supra* note 18. These corporations may prefer to keep their California sales, California payroll, and number of California shareholders to less than fifty percent of the total to avoid even the possibility of satisfying section 2115's prerequisites and thus having to comply with California regulations. *See* CAL. CORP. CODE § 2115 (West 2006).

[203] *VantagePoint*, 871 A.2d at 1109.

[204] *See id.*

[205] *See id.*

[206] *See id.* at 1109–10.

section 2115 of the California Corporations Code and that Examen was violating the statute by refusing to allow a class vote that was mandated by California law.[207]

On March 10, 2005, the Delaware court granted Examen's request for an expedited hearing and judgment.[208] Soon after, the California court decided to stay the California action while awaiting the decision of the Delaware court.[209] The Delaware Court of Chancery initially decided that the case was governed by the IAD and held for Examen.[210] VantagePoint appealed to the Supreme Court of Delaware, seeking to enjoin the merger's closing pending its judgment.[211] The injunction was denied, although the court did grant VantagePoint's request for an expedited appeal.[212] Examen closed its merger with Reed Elsevier on the same day.[213]

B. *Arguments Made by the Parties*

Examen argued that because the issue in dispute—shareholder voting rights—fell within the purview of the IAD, the IAD must be applied, regardless of California's regulations.[214] If the IAD applied, the judgment would be decided pursuant to Delaware law rather than California law because Delaware was the state of incorporation.[215] Examen asserted that its certificate of incorporation required the affirmative vote of the holders of a majority of its issued and outstanding shares of the common and preferred stock together, as if they were a single class.[216] Delaware corporate law allowed for this kind of provision and did not require Examen to provide for the voting of the common and preferred shares of stock as separate classes.[217] Accordingly, if Delaware

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[207] *See id.*; *see also* W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 727 (Ct. App. 1961). The *Sobieski* court nicknamed a corporation with its "technical domicile outside of this state but one which exercises most of its corporate vitality within this state" a "pseudo-foreign corporation." *See Sobieski*, 12 Cal. Rptr. at 727. The term "pseudo-foreign corporation" means a foreign corporation operating in California that has satisfied the prerequisites of § 2115 and can be regulated locally. *See id.* In *VantagePoint*, the Supreme Court of Delaware quoted the term "quasi-foreign corporation" to mean the same thing—a corporation qualifying under the prerequisites of § 2115. *See* 871 A.2d at 1109.

[208] *See VantagePoint*, 871 A.2d at 1110.

[209] *See id.*

[210] *See id.*

[211] *See id.*

[212] *Id.*

[213] VantagePoint, 871 A.2d at 1110.

[214] *See id.* at 1111.

[215] *See id.*

[216] *See id.* VantagePoint conceded that the charter did not provide for a vote by class, and that if Delaware law and the IAD prevailed, it would lose the judgment. *Id.*

[217] *See VantagePoint*, 871 A.2d at 1111.

law applied, Examen's charter would be upheld, it would not have to provide for voting by class, and its merger would be safe.[218]

VantagePoint, on the other hand, argued that in creating section 2115, California had promulgated a constitutional statute that was narrowly tailored to safeguard the important state interests of protecting California shareholders and other stakeholders.[219] VantagePoint stated that section 2115 was designed to provide an additional layer of investor protection by mandating that California's voting requirements apply in cases where a foreign corporation has chosen to conduct a majority of its business in California.[220] California's section 2115 mandates shareholder voting by class, which would allow VantagePoint to block the proposed merger.[221] Examen met the prerequisites of section 2115, as it was headquartered in Sacramento and had regional offices throughout California.[222] Therefore, VantagePoint urged the Delaware court to apply the California statute, rather than default to the traditional IAD, and force Examen to allow voting by class.[223]

C. *Decision of the Supreme Court of Delaware*

The court decided to utilize the IAD rather than to apply California's section 2115 and refused to force Examen to allow separate voting by class.[224] VantagePoint was thus unable to block the merger.[225] The court adhered to the policy goals behind the IAD and questioned the constitutional validity of section 2115, although it did not expressly say the statute was unconstitutional.[226]

Notably, the court expressly rejected VantagePoint's argument that California had an interest in regulating the internal affairs of foreign corporations.[227] It held that the only jurisdiction that can have any in-

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[218] *See id.*

[219] *See id.* at 1112.

[220] *See id.*

[221] *See* CAL. CORP. CODE § 2115 (West 2006).

[222] *See* Examen, Inc. v. VantagePoint Venture Partners, 873 A.2d 318, 320 (Del. Ch. 2005) *aff'd*, *VantagePoint*, 871 A.2d at 1118.

[223] *See VantagePoint*, 871 A.2d at 1112.

[224] *See id.* at 1116.

[225] *See id.*

[226] *See id.*

[227] *Id.* at 1113 ("'[A state] has no interest in regulating the internal affairs of foreign corporations.'" (quoting Edgar v. MITE Corp., 457 U.S. 624, 645–46 (1981))). Notably, the *VantagePoint* court selectively quoted the U.S. Supreme Court's opinion in *MITE* to reach a different conclusion than was originally stated in *MITE*. *See VantagePoint*, 871 A.2d at 1113. The *MITE* Court stated only that in the particular facts of that case, Illinois had no viable interest in regulating the disputed issue for foreign corporations, which it defined as corporations neither chartered within Illinois nor headquartered there. *See MITE*, 457 U.S. at

terest in doing so is the state of incorporation.[228] Because of this affirmation, California had no rights and interests outweighing those of Examen's corporate officers, directors, and shareholders in knowing at all times what law and standards of accountability will be applied to their actions.[229] Therefore, the court concluded that application of the IAD was mandated by the constitutional principles outlined in the Due Process and Commerce Clauses to uphold these interests.[230] The court noted that the only exception could be in the "rarest situations ... when the law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce."[231]

V. California Law Should Have Been Applied in *VantagePoint* in Accordance with Section 2115

The Supreme Court of Delaware should not have applied the IAD in *VantagePoint Venture Partners 1996 v. Examen.*[232] Instead, it should have recognized an exception to the IAD for California's section 2115, as courts in several other jurisdictions have done.[233] Examen met all of section 2115's prerequisites by willfully maintaining significant business operations in California, and so California law should have applied in accordance with the terms of the statute.[234]

Throughout its decision, the *VantagePoint* court erred in both its choice and interpretation of the relevant precedent that it cited.[235] First, the *VantagePoint* court misinterpreted the 1987 U.S. Supreme Court case *CTS Corp. v. Dynamics Corp. of America* in discussing whether or not section 2115 is constitutional.[236] The court also relied heavily on

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645–46. The *VantagePoint* court, on the other hand, left off the word "Illinois" from its reference to the *MITE* text and quoted the case to say that under the Commerce Clause *all* states have no interest in regulating the internal affairs of foreign corporations at any time. *See VantagePoint*, 871 A.2d at 1113.

[228] *See VantagePoint*, 871 A.2d at 1113.

[229] *See id.* at 1112–13.

[230] *See id.* at 1113.

[231] *See id.* (quoting *CTS Corp.*, 481 U.S. at 90).

[232] *See infra* notes 233–303 and accompanying text.

[233] *See* Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 261 (2d. Cir. 1984); Stephens v. Nat'l Distillers & Chem. Corp., No. 91-CIV-2901, 1996 WL 271789, at *4–5 (S.D.N.Y. May 21, 1996); Resolution Trust Corp. v. Gladstone, 895 F. Supp. 356, 363 (D. Mass. 1995); Weede v. Iowa S. Utils. of Del., 2 N.W.3d 372, 395 (Iowa 1942); Greenspun v. Lindley, 330 N.E.2d 79, 81 (N.Y. 1975).

[234] *See* Cal. Corp. Code § 2115 (West 2006); Examen, Inc. v. VantagePoint Venture Partners, 873 A.2d 318, 319–20 (Del. Ch. 2005) (stating the facts that were later relied on by the Supreme Court of Delaware in VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 (Del. 2005)).

[235] *See VantagePoint*, 871 A.2d at 1108–17.

[236] *See id.* at 1112; *supra* notes 192–197 and accompanying text.

the 2003 California Court of Appeal case *State Farm Mutual Automobile Insurance Co. v. Superior Court of Los Angeles County* to analyze California case law, but it selectively referenced and cited to the opinion, leaving out some critical text.[237] Further, the *VantagePoint* court ignored some of the express terms of the Restatement, which endorsed the viability of a California-type exception to the IAD, and instead emphasized other sections.[238] In this way, the court failed to recognize the gravamen of the argument in favor of California regulation.[239]

The glaring errors and poor reasoning in *VantagePoint* suggest that the court may have had some unstated concerns that undermine the result.[240] Delaware's leading role in charter competition and its stated public policy goal of providing a favorable climate for corporate organization, for example, may have contributed to the court's reluctance to recognize the validity of California's section 2115.[241] Delaware has a self-interest in keeping the hundreds of thousands of locally chartered corporations in state.[242] The annual franchise taxes paid by these corporations account for more than one-quarter of Delaware's revenues, as per its 2005 operating budget.[243] Had the

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[237] *See VantagePoint*, 871 A.2d at 1117; *supra* notes 105–113 and accompanying text.

[238] *See VantagePoint*, 871 A.2d at 1113, 1115; *supra* notes 142–153 and accompanying text. This selective application of the Restatement is consistent with how the Supreme Court of Delaware has invoked its use in past IAD litigation. *See* McDermott Inc. v. Lewis, 531 A.2d 206, 215 (Del. 1987).

[239] *See VantagePoint*, 871 A.2d at 1112, 1116, 1117 (referencing CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 69 (1986); Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 852 (Ct. App. 1983); State Farm Mut. Ins. Co. v. Super. Ct. of L.A. County, 8 Cal. Rptr. 3d 56, 56 (Ct. App. 2003)).

[240] *See id.* at 1108–16. Other recent commentary discussing *VantagePoint* has highlighted similar conclusions and has suggested that "Delaware decision makers (most notably its courts) will alter their behavior to the extent necessary to protect the state's chartering business from a federal takeover." Timothy P. Glynn, *Delaware's VantagePoint: The Empire Strikes Back in the Post-Post-Enron Era*, 102 Nw. U. L. REV. (forthcoming Jan. 2008), *available at* http://ssrn.com/abstract=966449 (discussing how the *VantagePoint* court acted to advance Delaware's interests by deterring all nonincorporating states and even the federal government from attempting to regulate corporate internal affairs).

[241] *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 663 (1974) (quoting Delaware's General Assembly in stating Delaware's public policy goals and suggesting that Delaware is leading a "race" to incorporate that federal regulation should curtail).

[242] *See* State of Delaware Division of Corporations, *supra* note 18 (explaining that Delaware is the leading state of incorporation in the United States). More than 280,000 corporations have chosen to incorporate in Delaware. *See id.*

[243] *See* STATE OF DEL. OFFICE OF MGMT. AND BUDGET, FINANCIAL OVERVIEW (2005), http://www.budget.delaware.gov/fy2005/operating/05opfinoverview.pdf (indicating that Delaware's operating budget for fiscal year 2005 was approximately $2.56 billion). In 2005, the state collected over $700 million in corporate franchise taxes, which amounted to more than one-fourth of the state's budget requirements. *See* U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS (2005), http://www.census.gov/govs/statetax/0508destax.html.

court recognized California's statute in Delaware, some of the Delaware-chartered corporations that would have fallen under section 2115 may have been motivated to reincorporate in California to avoid the dual regulatory structure and would have taken their franchise tax payments with them in doing so.[244] The *VantagePoint* court, however, was able to avert this risk by reasserting the IAD as a categorical rule in Delaware.[245] Therefore, the precedential value of *VantagePoint* should be considered in a skeptical light.[246]

A. *Errors Assigned to the Supreme Court of Delaware in* VantagePoint

The Supreme Court of Delaware made three critical errors in its *VantagePoint* opinion.[247] First, the court misinterpreted *CTS Corp.* and distorted the case's holding as controlling precedent.[248] Second, the *VantagePoint* court selectively cited to *State Farm*, and excluded a major point of contention emphasized by the California Court of Appeal in its opinion.[249] Third, the court neglected some relevant text of the Restatement that expressly embodies and endorses California's regulatory structure, while citing other portions of it that refer only to the IAD.[250]

1. Misinterpretation and Distortion of *CTS Corp.*

The *VantagePoint* court cited to *CTS Corp.* as if it were controlling precedent directly on point in an IAD dispute and made it the primary source of law throughout the opinion.[251] The court also relied on the Supreme Court of Delaware opinion in *McDermott Inc. v. Lewis*, which cited *CTS Corp.* for the same misconstrued principles.[252] In fact, however, *CTS Corp.* addressed a very different issue from the validity of the IAD, which was the issue in *VantagePoint*.[253] Therefore, the entire *Van-*

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[244] *See* Lucian A. Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Restructuring the Competition over Corporate Charters*, 112 YALE L.J. 553, 557 (2002) (indicating that Delaware assesses an annual franchise tax of up to $150,000 for large corporations).

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

[246] *See id.* at 1108.

[247] *See id.* at 1112–13, 1115, 1117 (discussing *CTS Corp.*, 481 U.S. at 69; *State Farm*, 8 Cal. Rptr. 3d at 56; RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 302, 309 (1971)).

[248] *See id.* at 1112.

[249] *See id.* at 1117.

[250] *See VantagePoint*, 871 A.2d at 1113, 1115.

[251] *See id.* at 1112–17.

[252] *See id.* at 1114–16.

[253] *See CTS Corp.*, 481 U.S. at 72 (stating that the question to be decided was whether the federal Williams Act preempted an Indiana corporate statute).

tagePoint opinion is based on shaky precedent, at best, which should have lead to a victory for California's section 2115 over the IAD.[254]

The actual dispute in *CTS Corp.* concerned Indiana's regulation of the hostile stock tender offer process involving Indiana corporations.[255] The issue was whether the governing Indiana statute, as applied to Indiana corporations, conflicted with the federal Williams Act.[256] In *VantagePoint,* however, the Supreme Court of Delaware cited to *CTS Corp.* as if the issue at hand were Indiana's regulation of foreign corporations.[257]

The Williams Act required that any hostile tender offer remain open for twenty days, whereas the Indiana statute required such an offer to remain open for fifty days.[258] Thus, the Indiana statute provided more protection for Indiana corporations subject to a hostile takeover by giving them an extra thirty days to attempt either to thwart the takeover process or to find a buyer willing to pay a higher price than the original tender offer.[259] The U.S. Supreme Court decided that the Williams Act did not preempt the Indiana statute and upheld the state's law.[260]

The Court reasoned that the Indiana statute was only adding an *additional* layer of protection to its own in-state corporations, and therefore did not actually conflict with or take anything away from federal law.[261] The Indiana statute added to the baseline regulations in the Williams Act, which was acceptable to the Court because it only concerned in-state corporations.[262] With its opinion, the U.S. Supreme Court merely endorsed the right of a state to regulate all of its own in-state corporations; it was not concerned with the proposition of a state attempting to regulate foreign corporations and whether that was legitimate.[263] Although the Court noted that so long as each state regulates only the corporations it has created, there will be no Commerce Clause problem because corporations will only be subject to the laws of one

[254] *See VantagePoint*, 871 A.2d at 1116.
[255] *See CTS Corp.*, 481 U.S. at 72–73, 78–79.
[256] *See id.*
[257] *See VantagePoint*, 871 A.2d at 1112, 1116.
[258] *See CTS Corp.*, 481 U.S. at 69.
[259] *See id.*
[260] *See id.* at 94.
[261] *See id.* at 93, 94.
[262] *See id.* at 93.
[263] *See CTS Corp.*, 481 U.S. at 89–96.

state, it never actually considered the possibility of a state's corporate law going beyond its own corporations.[264]

Nevertheless, in *VantagePoint*, the Supreme Court of Delaware cites to *CTS Corp.* for the proposition that only the state of incorporation can govern corporate internal affairs.[265] The court takes the U.S. Supreme Court's affirmative declaration that a state is permitted to regulate its own corporations liberally to mean that this is an exclusive right of the incorporating state, and that other states cannot also do so.[266] The *VantagePoint* court unreasonably leaps to the conclusion that a nonincorporating state is categorically banned from adding to the regulatory requirements of foreign corporations.[267]

This conclusion is not supported by *CTS Corp.*[268] *CTS Corp.* merely settles a dispute over the limitations of a state regarding the corporations chartered within it.[269] Just because the U.S. Supreme Court held that a state *may* safely regulate in-state corporations does not mean that it can *only* regulate in-state corporations nor that another state cannot also add to those regulations imposed by the incorporating state.[270] *CTS Corp.* in no way supports the proposition that, under the rare circumstances in which a corporation transacts all of its business in a foreign state, that foreign state can never apply its own additional regulations to those of the state of incorporation.[271] In *VantagePoint*, however, the Supreme Court of Delaware wrongly drew precisely this conclusion from *CTS Corp.* to validate its decision.[272]

2. Selective Citation to *State Farm* to Analyze California Case Law Erroneously

To bolster its opinion, the *VantagePoint* court discussed and cited to the California Court of Appeal decision in *State Farm*, and erroneously asserted that the IAD was now accepted as a categorical rule in Califor-

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[264] *See id.* at 89. Further, this statement was made only in support of the idea that a state does indeed have authority to regulate its own domestic corporations; it was not made in support of the idea that a state can only regulate domestic corporations or that another state cannot add to the regulation of its own corporations. *See id.* The next statement made by the Court was that "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations," which says nothing about a state's authority to also regulate nondomestic corporations. *Id.*

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

[266] *See id.*

[267] *See id.*

[268] *See CTS Corp.*, 481 U.S. at 89–96.

[269] *See id.*

[270] *See id.* at 93–94.

[271] *See id.* at 89–96.

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

nia.[273] The Supreme Court of Delaware stated that *State Farm* had cited the Delaware line of cases upholding the IAD as such a rule with approval.[274] Although this is partially true—*State Farm* did indeed cite approvingly to the Delaware decision in *McDermott* and even quoted a long portion of it—the *VantagePoint* court ignores a very important element of *State Farm*.[275]

The California Court of Appeal decided to use the IAD in the particular fact setting of *State Farm* because section 2115 was not implicated.[276] The foreign corporation at issue in the case had not established significant contacts in California by the terms of section 2115.[277] In those situations, the state upheld the validity of strictly using the IAD because no exception applied, and the policy behind section 2115 was not implicated.[278]

Most importantly, however, the *State Farm* court expressly endorsed California's right to regulate foreign corporations when the prerequisites of section 2115 are met.[279] In no uncertain terms, and completely contrary to the *VantagePoint* court's description and citation of the case, the *State Farm* court boldly reiterated the right of California to regulate foreign corporations.[280] It explained that "California law governs certain internal affairs of a foreign corporation if more than half of the corporation's voting stock is held by California residents, and the corporation conducts a majority of its business in the state . . . ."[281] Furthermore, the *State Farm* court also noted that California law can even be used to regulate the dividends of a foreign corporation—which are typically insulated by the business judgment rule in the incorporating state—and cited to section 2115.[282]

Therefore, California has not abandoned or ceded its right to regulate the internal affairs of foreign corporations, as the Supreme Court of Delaware incorrectly stated in *VantagePoint*.[283] The recent decision of a California Court of Appeal in *Friese v. Superior Court of San Diego County* in 2005 further illustrates the error of the *VantagePoint*

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[273] *See id.* at 1117.
[274] *See id.*
[275] *See id.*; *State Farm*, 8 Cal. Rptr. 3d at 68–69.
[276] *See State Farm*, 8 Cal. Rptr. 3d at 61, 68–69.
[277] *See id.*
[278] *See id.*
[279] *See id.* at 69.
[280] *Id.*
[281] *See State Farm*, 8 Cal. Rptr. 3d at 69.
[282] *See id.*
[283] *VantagePoint*, 871 A.2d at 1117.

court.[284] In this case, the California court reemphasized its right to apply local law to foreign corporations in saying that "[i]n some situations . . . the local court may, in the interest of justice, take jurisdiction over internal affairs and apply the local law."[285]

The *VantagePoint* court should have taken notice of California's steadfast support for section 2115.[286] Instead, the court stated that it had no doubt that the California courts would apply Delaware law to the internal affairs of a Delaware corporation, even when the prerequisites of section 2115 are met or exceeded.[287] This conclusion is unfounded, and it highlights a serious flaw in the opinion that Delaware courts should recognize if called upon to reconsider *VantagePoint*'s holding.[288]

3. Exclusion of Relevant Portions of the *Restatement (Second) of Conflict of Laws*

In its opinion in *VantagePoint*, the Supreme Court of Delaware twice cited the *Restatement (Second) of Conflict of Laws*.[289] The court first relied on section 301 to outline the general policy goals behind maintaining the IAD, and it then referenced section 302 because it has been cited with approval by the U.S. Supreme Court.[290] The Supreme Court of Delaware also cited these Restatement sections with approval in *McDermott*, where it previously mandated the use of the IAD as a categorical rule.[291] The *VantagePoint* court relied heavily on *McDermott* and referenced it as the definitive Delaware case concerning the IAD.[292]

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[284] *See* Friese v. Super. Ct. of San Diego County 36 Cal. Rptr. 3d at 569 (Ct. App. 2005). Notably, the California Supreme Court and the U.S. Supreme Court denied review and certiorari, respectively, which tends to indicate their acquiescence in the California Court of Appeal decision. *See* Moores v. Friese, 127 S. Ct. 138, 138 (2006); Friese v. San Diego County Super. Ct., 2006 Cal. LEXIS 3559, at *1 (Mar. 15, 2006).

[285] *See Friese*, 36 Cal. Rptr. 3d at 569 (quoting 9 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW § 239 (10th ed. 2005)).

[286] *See id.*; *State Farm*, 8 Cal. Rptr. 3d at 69.

[287] *See VantagePoint*, 871 A.2d at 1117.

[288] *See id.*

[289] *See id.* at 1113, 1115.

[290] *See* Kamen v. Kemper Fin. Serv., 500 U.S. 90, 106 (1991) ("'Uniform treatment of directors, officers and shareholders is an important objective which can only be attained by having the rights and liabilities of those persons with respect to the corporation governed by a single law.'" (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. e (1971))); *see also CTS Corp.*, 481 U.S. at 89 (citing with approval RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 304 (1971)).

[291] *See McDermott*, 531 A.2d at 215 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 302–306, 309 (1971)).

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

Although the court relied on the *Restatement*, it did so selectively, which further contributed to its errors in *VantagePoint*.[293] Section 302 of the Restatement has two parts—the first part generally states the IAD, but the second part basically codifies California's policy in regulating foreign corporations with section 2115.[294] In relevant part, section 302(2) states that the law of the state of incorporation will be applied in an internal affairs dispute *unless* some other state has a more significant relationship to the occurrence and the parties.[295]

California's statute embodies this exception for when a state has a more significant relationship to a corporation than the incorporating state, and the Restatement supports this statute.[296] Most notably, comment g to the Restatement uses the California case of *Western Airlines, Inc. v. Sobieski* to demonstrate the rejection of the IAD as a categorical rule and to explain the exception provided by section 2115.[297] Further, the Reporter's Notes to section 302 explain that the statutes of both California and New York specifically allow for these states to regulate the internal affairs of foreign corporations with significant business contacts within them.[298]

In discussing the Restatement and using it to support the IAD, however, the *VantagePoint* court inexplicably failed to acknowledge the second part of section 302 even though it is a major portion of the text.[299] The court similarly failed to recognize that the Restatement points to California case law to justify an exception to the IAD expressly codified in this section.[300] Instead, the court merely highlights and accepts those portions of the Restatement that are consistent with applying the IAD as a categorical rule.[301] The Supreme Court of Delaware, therefore, seems to have contradicted itself or at least to have made an incomplete conclusion of law.[302] It highlighted and cited to the Restatement to justify using the IAD, but at the same time it failed to recognize that the very same portion of the Restatement to

[293] *See id.* at 1113, 1115.

[294] *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

[295] *Id.*

[296] *See id.* cmt. g.

[297] *See id.*

[298] *See id.* reporter's note to cmt. g.

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

[300] *See id.*; RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. g (1971) (citing *Wilson*, 187 Cal. Rptr. at 852).

[301] *See VantagePoint*, 871 A.2d at 1113, 1115.

[302] *See id.*

which it pointed fully incorporates California's exception to the IAD in section 2115.[303]

B. *The Supreme Court of Delaware's Decision in* VantagePoint *May Have Been Driven by State Self-Interest in Corporate Franchise Tax Revenues*

The fact that the Supreme Court of Delaware seems to have misconstrued and selectively excluded relevant legal precedent in its *VantagePoint* opinion is not difficult to understand when considering what was at stake in the outcome for Delaware.[304] The state is fiscally dependent on the revenues that its countless in-state corporations provide every year via franchise taxes.[305] Had the court opted to recognize an exception to the IAD for California's section 2115, it is plausible that some of these corporations would have reincorporated in California to simplify their regulatory burdens rather than deal with Delaware and California internal affairs restrictions simultaneously.[306] This possibility—that section 2115 corporations would take their franchise tax payments out of state—could have cost the Delaware state government many millions of dollars.[307] Therefore, Delaware's self-interest in retaining these revenues may have been a driving force behind the court's *VantagePoint* decision.[308]

Delaware is by far the leading state of incorporation in the United States.[309] More than fifty percent of all publicly traded companies in the country have chosen to incorporate in Delaware, including sixty percent of the Fortune 500.[310] It has dominated the nation in number of all chartered corporations since the early 1900s, when other key states

[303] *See id.*; RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

[304] *See* 871 A.2d at 1112–13, 1115, 1117 (discussing *CTS Corp.*, 481 U.S. at 69; *State Farm*, 8 Cal. Rptr. 3d at 56; RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 302, 309 (1971)).

[305] *See* U.S. CENSUS BUREAU, *supra* note 243 (indicating that Delaware raised over $700 million in corporate franchise taxes in fiscal year 2005).

[306] *See Wilson*, 187 Cal. Rptr. at 857–58 (forcing a Utah corporation to comply with both Utah and local California internal affairs regulations); W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 724 (Ct. App. 1961) (holding that a Delaware corporation could be forced to comply with both Delaware and local California internal affairs regulations).

[307] *See* Bebchuk & Hamdani, *supra* note 244, at 557 (indicating that Delaware assesses an annual franchise tax of up to $150,000 for large corporations).

[308] *See* 871 A.2d at 1116; *see also* Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 643–44 (2004) (discussing the Delaware judiciary's response to a broad range of threats to Delaware's market dominance in number of incorporated entities).

[309] *See* Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1061 (2000); *see also* State of Delaware Division of Corporations, *supra* note 18 (explaining that Delaware is the leading state of incorporation in the United States).

[310] *See* State of Delaware Division of Corporations, *supra* note 18.

amended their corporate laws unfavorably.[311] By 1965, thirty-five percent of all companies listed on the NYSE were Delaware corporations; by 1973, this number had risen to forty percent; and by 2000, approximately half of all NYSE companies were incorporated in Delaware.[312] Delaware now charters more than 3700 publicly traded companies, whereas the next largest total in any state is less than 200.[313]

Delaware's dominant position in collecting corporate charters enables it to make substantial revenues by assessing an annual franchise tax of up to $150,000 for large entities.[314] In the aggregate, these revenues constitute a considerable portion of the state's annual operating budget.[315] In fiscal year 2005, for example, the state's operating budget was approximately $2.56 billion.[316] Delaware collected over $700 million in corporate franchise taxes for the same year, representing more than one-quarter of the total.[317] The 2005 population of Delaware was roughly 844,000, which means that for each family of four, on a per capita basis, the state captured approximately $3300 in revenues from incorporations.[318]

Without its thousands of locally chartered corporations, Delaware would conceivably have to raise state income taxes by a similar amount to maintain the same level of services that the state currently provides.[319] The risk that some Delaware corporations would move to California may have loomed too large for the Delaware courts to overlook and could have driven their decision to disregard California's exception to the IAD.[320] Instead, by keeping a stronghold on internal

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[311] *See* Demetrios G. Kaouris, *Is Delaware Still a Haven for Incorporation?*, 20 DEL. J. CORP. L. 965, 969–71 (1995) (explaining Delaware's rise to prominence beginning in 1913 when New Jersey passed legislation effectively outlawing trusts and holding companies).

[312] Subramanian, *supra* note 1, at 1802.

[313] *See* Lucian A. Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 418 tbl.12 (2003).

[314] *See* Bebchuk & Hamdani, *supra* note 244, at 557.

[315] *Compare* STATE OF DEL. OFFICE OF MGMT. AND BUDGET, *supra* note 243 (showing that Delaware's fiscal year 2005 operating budget was $2.56 billion), *with* U.S. CENSUS BUREAU, *supra* note 243 (showing that for the same year, Delaware brought in over $700 million in corporate franchise tax revenues, which amounted to over one-fourth of the $2.56 billion budget).

[316] *See* STATE OF DEL. OFFICE OF MGMT. AND BUDGET, *supra* note 243.

[317] *See* U.S. CENSUS BUREAU, *supra* note 243.

[318] *See id.* (showing both the population and corporate franchise tax assessment statistics). $700 million—divided by 211,000 average size families of four—equals approximately $3330 per family. *See id.*

[319] *See* STATE OF DEL. OFFICE OF MGMT. AND BUDGET, *supra* note 243 (briefly explaining the major categories and extent of state expenditures).

[320] *See* Bebchuk & Hamdani, *supra* note 244, at 557. Each large corporation represents $150,000 annually to the Delaware state government. *See id.*

affairs regulation in the state of Delaware by using the IAD as a categorical rule, the *VantagePoint* court substantially reduced this risk.[321] It assured all Delaware corporations that, even though the law is unsettled between California and Delaware, so long as any internal affairs dispute actions are filed in their home state first, they will only have to comply with local regulations.[322] The Supreme Court of Delaware, throughout its opinion in *VantagePoint,* may very well have calculated that this assurance would be enough to keep its corporations in state to protect its massive franchise tax revenues.[323]

Conclusion

Traditionally, the IAD only allows the state of incorporation to regulate corporate internal affairs. In creating section 2115, the California legislature did not attempt to give a nonincorporating state free reign to regulate liberally any foreign corporation operating within state boundaries. Nor did it attempt to abolish all use of the IAD in resolving corporate internal affairs disputes. Rather, section 2115 is narrowly focused and is meant only to allow California to regulate those corporations that significantly take advantage of California resources, but are incorporated elsewhere. The statute's three-tiered prerequisites guarantee that only corporations that purposefully move into California to establish substantial in-state business contacts face the possibility of having to comply with both California regulations and those of their actual incorporating states.

Although several other jurisdictions approve of the policy behind California's section 2115 and even support similar regulatory measures, Delaware has taken issue with it and refuses to allow any exceptions to the categorical rule of the IAD. Most recently, in 2005, the Supreme Court of Delaware severely criticized section 2115 in *VantagePoint Venture Partners 1996 v. Examen, Inc.* and upheld the status quo of the IAD even though the California statute's prerequisites were met by a Delaware corporation. Even in the face of this out-of-state criticism, however, California courts continue to support and enforce section 2115. This disconnect between two of the major players in corporate law leaves the futures of large, multi-state corporations uncertain, as there are many that are incorporated in Delaware but operate significantly in California. For now, internal affairs litigation

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[321] *See VantagePoint*, 871 A.2d at 1116.
[322] *See id.*; *McDermott*, 531 A.2d at 219.
[323] *See VantagePoint*, 871 A.2d at 1109–18.

commencing in Delaware will be decided under the IAD, whereas it will be decided under section 2115 should it begin in California.

Delaware should have recognized section 2115 as an exception to the IAD, just as several courts in other jurisdictions have done. Instead, the *VantagePoint* court used faulty reasoning and misconstrued relevant precedent to reach the conclusion that the IAD should be an absolute rule. By doing so, the court protected Delaware's self-interest in retaining its dominance in number of incorporated entities. These countless in-state business entities pour hundreds of millions of dollars into the Delaware treasury every year in corporate franchise taxes. Had the Supreme Court of Delaware accepted California's section 2115, it would have run the risk of some of these Delaware corporations reincorporating in California to avoid having to comply with dual regulatory standards. Without these corporations, the state government of Delaware would have had to look elsewhere for revenue. The undesirability of this course of action may explain the court's erroneous opinion in *VantagePoint*, which should be highlighted if relied on in the future.

MATT STEVENS