

PROBLEMS IN THE FIELD OF STATE SECURITIES REGULATION

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I. A PREVIEW OF WESTERN AIR LINES†

A. STATEMENT

A troublesome problem in the field of state securities regulation is the extent to which any particular "blue sky law" *does* regulate, and, in fact, constitutionally *can* regulate a so-called "transaction effected without entering the state."¹ This problem has become particularly acute recently because of the decision of the California Superior Court in *Western Air Lines, Inc. v. Stephenson, Comm'r*, a decision which has far-reaching implications.²

The transactions to be analyzed are grouped into two categories. The first category involves the problem of whether an offer or sale effected in a state solely via the mails, or some interstate facility, by a foreign issuer or broker, is covered by that state's securities law; and, if so, whether that statute is constitutional.³ The second category involves this question: where a foreign corporation amends its certificate of incorporation to change the rights of its shareholders, and where all or nearly all of the steps necessary to accomplish this change are effected beyond the borders of the state which seeks to

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¹ Loss & Cowett, Blue Sky Law 210 (1958); Loss, The Conflict of Laws and the Blue Sky Laws, 71 Harv. L. Rev. 209 (1957); Cowett, Reorganizations, Consolidations, Mergers and Related Corporate Events Under the Blue Sky Law, 13 Bus. Law. 418, 760 (1958); Reese and Kaufman, The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit, 58 Colum. L. Rev. 1118 (1958); Jennings, The Role of the States in Corporate Regulation and Investor Protection, 23 Law & Contemp. Prob. 193, 220 (1958); Sterling, Amendments to California Corporations Laws, 1937: Readjusting Stock Structure, 26 Calif. L. Rev. 76, 86 (1937); Smith, State 'Blue Sky' Laws and the Federal Securities Acts, 34 Mich. L. Rev. 1135, 1141 (1936); Klagsbrunn, Regulation of Interstate Security Sales—A Recent Report, 1 U. Chi. L. Rev. 88 (1933).

² File No. LA-5822, Calif. Div. of Corps., Feb. 5, 1958, rev'd, Blue Sky L. Rep. ¶ 70,396 (Calif. Super. Ct., L.A. County, July 17, 1958), rev'd sub nom. *Western Air Lines, Inc. v. Sobieski, Comm'r*, 12 Cal. Rptr. 719 (Dist. Ct. App. 1961).

³ This problem has arisen in a few reported decisions: *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 188 Va. 877, 51 S.E.2d 263 (1949), aff'd, 339 U.S. 643 (1950); *Merrick v. N. W. Halsey & Co.*, 242 U.S. 568 (1917); *Bartlett v. Doherty*, 10 F. Supp. 465 (D.N.H. 1935), aff'd in part and rev'd in part, 81 F.2d 920 (1st Cir.), cert. denied sub nom. *Doherty v. Knowlton*, 298 U.S. 676 (1936).

regulate, can that state demand that the corporation apply for and be granted a permit before such a change is finally adopted on the ground that there are resident shareholders to protect? In *Western Air Lines* the change which the Delaware corporation sought to adopt was an elimination of cumulative voting. In *Western States Petroleum Co.*⁴ the Delaware corporation sought to effectuate a plan of merger. In both cases, all or nearly all⁵ of the steps necessary to effect the change culminating in the charter amendment occurred outside California, and in both cases the commissioner of corporations demanded a permit. Thus, in both categories the inquiry will be directed first at a construction of the statute to see whether in its terms these transactions are covered; and, second at the constitutional problems involved when a state statute is so interpreted to permit regulation.

The purpose of this article is not to examine the case of the sale or exchange of securities with contacts in two or more states, and the conflicts problem of what law governs the validity of that sale.⁶

⁴ File No. LA-16541, Calif. Div. of Corps., Dec. 8, 1959. This case did not reach the courts since the permit was issued.

⁵ There was proxy solicitation in California in *Western Air Lines*; the effect of this on the power of California to regulate will be examined below.

⁶ Most states follow the rule that the law of the place of contract governs, or the place where the last act necessary to make a binding contract occurs. Restatement, Conflict of Laws §§ 311, 332 (1934); *Brocalso Chem. Co. v. Langsenkamp*, 32 F.2d 725 (6th Cir. 1929); *Lack v. Borsum*, 44 F. Supp. 47 (W.D. La. 1942); *Hohn v. Peters*, 216 Cal. 406, 14 P.2d 519 (1932); *Leven v. Legarra*, 103 Cal. App. 2d 319, 229 P.2d 383 (1951); *People ex rel. Brundage v. Hill Top Metals Mining Co.*, 300 Ill. 564, 133 N.E. 303 (1921); *Duke v. Olson*, 240 Ill. App. 198 (1926); *California Palisades Inc. v. Manley*, 214 Ind. 565, 16 N.E.2d 886 (1938); *Somers v. Commercial Fin. Corp.*, 245 Mass. 286, 139 N.E. 837 (1923); *Guynn v. Shulters*, 223 Miss. 232, 78 So. 2d 114 (1955); *Gales v. Weldon*, 282 S.W.2d 522 (Mo. 1955); *McManus v. Fulton*, 85 Mont. 170, 278 Pac. 126 (1929); *Rhines v. Skinner Packing Co.*, 108 Neb. 105, 187 N.W. 874 (1922); *Russell v. Ruffcorn*, 54 Nev. 162, 10 P.2d 632 (1932); *Gillespie v. Blood*, 81 Utah 306, 17 P.2d 822 (1932); *United States Bond & Fin. Corp. v. National Bldg. & Loan Ass'n*, 80 Utah 62, 12 P.2d 758 (1932); *Coral Gables Corp. v. Clay*, 153 Va. 554, 149 S.E. 519 (1929); *Estate of Suckow*, 192 Wis. 124, 212 N.W. 280 (1927); *Goodrich, The Conflict of Laws* §§ 107, 110 (3d ed. 1949); *Fletcher, Private Corporations* § 6742 (repl. vol. 1954); 2 Beale, *The Conflict of Laws* § 332.57 (1935).

There is some authority for choosing the law of the place of performance to govern: *Persen v. National City Co.*, 129 F.2d 326 (2d Cir. 1942); *In re Motor Products Mfg. Corp.*, 90 F.2d 8 (9th Cir. 1937); *Los Angeles Fisheries, Inc. v. Crook*, 47 F.2d 1031 (9th Cir. 1931); *Robbins v. Pacific Eastern Corp.*, 8 Cal. 2d 241, 65 P.2d 42 (1937); *Jones v. Re-Mine Oil Co.*, 47 Cal. App. 2d 832, 119 P.2d 219 (1941); Restatement, Conflict of Laws § 332, comment b (1934).

There is also some authority for fixing the law of the place of the offer as the governing law: *Intermountain Title Guar. Co. v. Egbert*, 52 Idaho 402, 16 P.2d 390 (1932); *Lewis v. Bricker*, 235 Mich. 656, 209 N.W. 832 (1926); *Streissguth v. Chase Sec. Corp.*, 198 Minn. 17, 268 N.W. 638 (1936); or, the law having the most "contacts" with the contract: *Global Commerce Corp. v. Clark-Babbitt Indus., Inc.*, 239 F.2d 716 (2d Cir. 1956); *W. H. Barber Co. v. Hughes*, 223 Ind. 570, 63 N.E.2d 417 (1945); *Westlake, Private International Law* § 212 (7th ed. 1925).

Furthermore, it is not necessary to consider whether a state can regulate where the vendor or offeror enters the state and carries on negotiations leading to a sale either within that state or elsewhere; this seems to be constitutionally permissible.⁷ The real problem is that situation where a foreign corporation never enters the regulating state, and yet effects either an offer or a sale there, or some change in the rights of resident shareholders.

This problem concerns the power to regulate transactions without entering the state, and is to be distinguished from the problem of enforcement—topics which are often confused.⁸ Although the recent decisions on the question of enforcement by substituted process on the non-resident indicate a broadening concept of state jurisdiction,⁹ it is wise at the outset to separate the due process tests sustaining substituted service, and the constitutional tests sustaining a power to regulate. The problem of enforcement by extradition as well as by substituted service is beyond the scope of this article.¹⁰

⁷ See *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917); *Caldwell v. Sioux Falls Stock Yards Co.*, 242 U.S. 559 (1917); *Merrick v. N. W. Halsey & Co.*, 242 U.S. 568 (1917); cf. *Gillis v. Pan American Western Pet. Co.*, 3 Cal. 2d 249, 44 P.2d 311 (1935); *London, Paris & American Bank v. Aronstein*, 117 Fed. 601 (9th Cir. 1902); *Biddle v. Smith*, 148 Tenn. 489, 256 S.W. 453 (1923).

⁸ See *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 339 U.S. 643 (1950), in which the majority confuses the two problems. The dissenting opinion did attempt to distinguish them: "We are not dealing here with the power of Virginia to regulate the transaction of insurance business with its citizens, as was the case in *Osborn v. Ozlin* . . . and *Hoopeston Co. v. Cullen*. . . . In the case at bar we are only concerned with how Virginia may enforce such power as it has." *Id.* at 659.

⁹ The cases indicate a trend that jurisdiction will be sustained to enter a judgment on substituted service in an action against a non-resident even in a case arising out of an isolated transaction effected via the mails: *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957); *Zacharakis v. Bunker Hill Mut. Ins. Co.*, 281 App. Div. 487, 120 N.Y.S.2d 418 (1953). But see *Hanson v. Denckla*, 357 U.S. 235 (1958), where substituted service on a non-resident was not sustained in a case where the "contact" with the serving state was both isolated and unconnected with the dispute. See also *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 188 Va. 877, 51 S.E.2d 263 (1949), *aff'd*, 339 U.S. 643 (1950); *International Shoe Co. v. Washington*, 326 U.S. 310 (1945); *Schutt v. Commercial Travellers Mut. Acc. Ass'n*, 229 F.2d 158 (2d Cir. 1956); *Florence Nightingale School of Nursing v. Superior Court*, 168 Cal. App. 2d 74, 335 P.2d 240 (1959); *Flynn v. Physicians Casualty Ass'n*, 20 Conn. Supp. 240, 131 A.2d 336 (Super. Ct. 1957). But see *Anschell v. Sackheim*, 145 F. Supp. 447 (D.N.J. 1956); *Insull v. New York World-Telegram Corp.*, 172 F. Supp. 615 (N.D. Ill. 1959); *Putnam v. Triangle Publications*, 245 N.C. 432, 96 S.E.2d 445 (1957). The latter two cases are libel cases holding that a foreign publishing corporation is not "doing business" in a state for purposes of substituted service simply because its periodicals are sold in the state.

¹⁰ The extradition clause of the Constitution, U.S. Const. art. IV, § 2, cl. 2, provides that "A person charged in any State with Treason, Felony, or other Crime, who shall flee from Justice and be found in another State, shall on Demand of the executive authority of the State from which he fled, be delivered up, to be removed to the State

B. RELEVANT CONSTITUTIONAL CONSIDERATIONS

There are at least four clauses of the Constitution which are relevant in determining whether a state can regulate a transaction effected within the state, where the defendant issuer or broker, as the case may be, has never entered the state.¹¹ These clauses are the contract clause, the commerce clause, the due process clause, and the full faith and credit clause.

1. *The Contract Clause.* It has been held in the case of a common law sale within the regulating state (sale A) that the securities law is not constitutional within the purview of the contract clause.¹² The transactions to be examined here also include a sale within the state, and at least in the first category to be examined, a contract in the common law sense of an offer, acceptance and consideration; but effected in such a way that the issuer or dealer does not enter the state (sale B). In an effort to discover on what constitutional grounds regulation of sale B might be attacked, it is perhaps not enough to say either that it is different from sale A or that sale B, and not sale A, is within the protection of the contract clause. Where it is necessary to distinguish between sales made in the state, any constitutional

having jurisdiction of the Crime." If the person were not in the state at the time the crime was committed he would not be a fugitive from justice under the clause: *Hyatt v. Corkran*, 188 U.S. 691 (1903); *Ex parte Shoemaker*, 25 Cal. App. 551, 144 Pac. 985 (1914); *Ex parte Heath*, 87 Mont. 370, 287 Pac. 636 (1930). This problem may not prove fatal since nearly all of the states have passed the Uniform Criminal Extradition Act. For example, Ala. Code tit. 15, §§ 48-75 (1958). Section 53 provides:

The governor of this state may also surrender on demand of the executive authority of any other state, any person in this state charged on indictment found in such other state with committing an act in this state intentionally resulting in a crime in such other state, and the provisions of this article not otherwise inconsistent shall apply in such cases notwithstanding that the accused was not in that state at the time of the commission of the crime, and has not fled therefrom.

See *Timbers and Pollack*, *Extradition from Canada to the U.S. for Securities Fraud: Frustration of the National Policies of Both Countries*, 16 Fed. B. J. 31 (1956). For a general discussion of the enforcement problems arising out of *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 188 Va. 877, 51 S.E.2d 263 (1949), *aff'd*, 339 U.S. 643 (1950), see Note, 64 Harv. L. Rev. 482 (1951).

¹¹ In *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 339 U.S. 643, 651 (1950), mention is made in the majority opinion of a constitutional argument based on an infringement of the federal control of the mails. However, since that argument was not included in appellant's brief on submission of the case, the Court did not address itself to that point. It is suggested, however, that the clause on the mails adds little, if anything, to an argument based on the commerce clause. The argument based on the mails was specifically rejected by the Supreme Court of Virginia: *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 188 Va. 877, 51 S.E.2d 263 (1949).

¹² In *re MacLean*, 147 Kan. 678, 78 P.2d 855 (1938); *Commissioner of Banks v. Chase Sec. Corp.*, 298 Mass. 285, 10 N.E.2d 472 (1937), appeal dismissed, 302 U.S. 660 (1938); *State v. Nordstrom*, 169 Minn. 214, 210 N.W. 1001 (1926).

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argument must advance the reasons why sale B should be immune from state regulation. One such reason is that the state seeking to regulate does not have a sufficient "governmental interest" or contact with the transaction; *i.e.*, it belongs to Congress (commerce clause) or to another state (full faith and credit clause) to regulate; or whoever can regulate, state X can not (due process). The other clauses are necessary to supply the added constitutional ballast to weigh in the scales against the police power, to attempt a differentiation between sale A and sale B, and to explain why the latter and not the former may be constitutionally protected. Most of the cases which involve prohibitions on the state for "reaching out" beyond its jurisdiction in an area not competent for it to legislate, and which contain references to the contract clause, also contain references to full faith and credit and due process.¹³

2. *The Commerce Clause.* The commerce clause is also of doubtful assistance in developing a constitutional argument against regulation of transactions without entering the state. Whenever a state is held incompetent to apply its law to an interstate transaction on the ground of the commerce clause, it is not because the law of another state is applicable, but because the law of no state is applicable—"regulation of inter-state commerce being committed by the Constitution to the Federal Government."¹⁴

In considering whether a transaction without entering the state is the type of transaction which can only be regulated by the federal government, it should be noted that Congress in five out of the six statutes administered by the SEC has made specific provisions preserving the blue sky laws.¹⁵ Moreover, even before these specific provisions were enacted, the Supreme Court in a series of cases decided that the commerce clause did not impede a state from regulating

¹³ Bayard v. Traders Gen. Ins. Co., 99 F. Supp. 343 (W.D. La. 1951); Holderness v. Hamilton Fire Ins. Co., 54 F. Supp. 145 (S.D. Fla. 1944). See also Aetna Life Ins. Co. v. Dunken, 266 U.S. 389 (1924). For a detailed examination of the contract clause see Hale, The Supreme Court and Contract Clause, 57 Harv. L. Rev. 512, 621, 852 (1944).

¹⁴ Ross, Has the Conflict of Laws Become a Branch of Constitutional Law?, 15 Minn. L. Rev. 161, 165 (1931).

¹⁵ Securities Act § 18, 48 Stat. 85 (1933), 15 U.S.C. § 77r (1958); Securities Exchange Act § 28(a), 48 Stat. 903 (1934), 15 U.S.C. § 78bb(a) (1958); Public Utility Holding Company Act § 21, 49 Stat. 834 (1935), 15 U.S.C. § 79u (1958); Trust Indenture Act § 326, 53 Stat. 1177 (1939), 15 U.S.C. § 77zzz (1958); Investment Company Act § 50, 54 Stat. 846 (1940), 15 U.S.C. § 80a-49 (1958). The Interstate Commerce Act § 20a, 41 Stat. 494 (1920), 49 U.S.C. § 20a (1958), gives the ICC exclusive power to regulate the issuance of securities by any carrier subject to its jurisdiction. Mr. Cowett states that this pre-emption in the latter act has not been followed, because some states for some unknown reason require registration of securities of carriers subject to the ICC. Cowett, *supra* note 1, at 764.

securities transactions within the state, even though in one case the securities dealer merely directed offers into the state by means of interstate facilities, and never himself entered the state.¹⁶

Therefore, although the federal statutes do not in so many words say that the states are left with the power to regulate the transaction without entering the state, blue sky laws are preserved generally, and there is at least one decision—although without reasoning on the point—holding that state regulation of this transaction is not contrary to the commerce clause.¹⁷ Moreover, even in the second category of transactions effected by charter amendments, the competition would appear to be between two or more state schemes of regulation, rather than competition between a state and the federal government.¹⁸ Thus, this article will examine in greater detail the implications of the due process and the full faith and credit clauses as to both categories.

3. *Due Process and Full Faith and Credit.* The test which appears to be applied when due process is argued in a case involving legislative jurisdiction is as follows: does the forum have a sufficient "governmental interest" to justify its action; or, as one distinguished commentator has phrased it: "Does the state have a legitimate interest in the application of its policy?"¹⁹ This point of view has considerable case law support.²⁰

¹⁶ *Merrick v. N. H. Halsey & Co.*, 242 U.S. 568 (1917). The foreign partnership in this case was one of a number of complainants seeking to enjoin the enforcement of the Michigan blue sky law. The Court sustained the constitutionality of the statute without expressly dealing with the special problem raised by the type of business in which this partnership was engaged. Moreover, the decision from this point of view is even less satisfactory since the Court merely said: "Answer to the contention that the statute is an interference with inter-state commerce we leave to our opinion in [Hall v. Geiger-Jones Co., 242 U.S. 539 (1916)]." *Id.* at 590.

¹⁷ See *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 188 Va. 877, 51 S.E.2d 263 (1949), *aff'd*, 339 U.S. 643 (1950). But see two unofficial opinions of the securities commissioners of Idaho and South Carolina who believe that if this type of offer or sale is covered by any of the statutes administered by the SEC, then their respective state statutes cannot be applied. Letter from R. U. Spaulding, Commissioner of Finance, State of Idaho, to the author, Jan. 22, 1960; letter from R. L. Kelly, Securities Commissioner, State of South Carolina, to the author, March 16, 1960. Both letters are on file in the Harvard Law Library.

¹⁸ See *Western Air Lines v. Stephenson*, Comm'r, Blue Sky L. Rep. ¶ 70,396 (Calif. Super. Ct., L.A. County, July 17, 1958).

¹⁹ Currie, *The Constitution and the Choice of Law: Governmental Interest and the Judicial Function*, 26 U. Chi. L. Rev. 9, 49 (1958). For other articles in general accord with the conclusion stated in the text see: Reese and Kaufman, *supra* note 1, at 1129; Reese, *Full Faith and Credit to Statutes: The Defense of Public Policy*, 19 U. Chi. L. Rev. 339, 342 (1952); Hilpert and Cooley, *The Federal Constitution and the Choice of Law*, 25 Wash. U.L.Q. 27, 50, 55 (1939).

²⁰ *Watson v. Employers Liab. Corp.*, 348 U.S. 66 (1954); *Alaska Packers Ass'n v. Industrial Acc. Comm'n*, 294 U.S. 532 (1935); *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930); *Aetna Life Ins. Co. v. Dunken*, 266 U.S. 389 (1924); *National Ins. Co. v. Wanberg*, 260 U.S. 71 (1922); *New York Life Ins. Co. v. Dodge*, 246 U.S. 357 (1918);

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The more troublesome question today, however, is whether the full faith and credit clause says any more than the due process clause. There are, for example, a number of commentators who think that the same test applies to both.²¹ They say that the full faith and credit clause and the due process clause complement each other in choice of law situations involving the statute law of sister states. Thus, if a state with no "governmental interest" applies its own statute to a transaction, it is a denial of due process; and, if at the same time they refuse to apply the statute of a sister state which *is* based on a sufficient "governmental interest," it is a denial of full faith and credit.²² Other writers have taken the position that the full faith and credit clause requires the court to weigh the relevant national and state interests and to choose the law of that state with the superior interest.²³ Although a reading of the relevant decisions in this area does not provide a clear answer to this problem, the majority of the cases can

Kryger v. Wilson, 242 U.S. 171 (1916); New Lork Life Ins. Co. v. Head, 234 U.S. 149 (1914); Slater v. Mexican Nat'l R.R., 194 U.S. 120 (1904); Sun Life Ins. Office Ltd. v. Clay, 265 F.2d 522 (5th Cir. 1959); Holderness v. Hamilton Fire Ins. Co., 54 F. Supp. 145 (S.D. Fla. 1944). Hartford Acc. & Indem. Co. v. Delta Co., 292 U.S. 143 (1934), has been criticized in that it overlooked the "governmental interest" of Mississippi, the place where the loss occurred. Currie, *supra* note 19, at 44-46. See also in this connection Bayard v. Traders and Cen. Ins. Co., 99 F. Supp. 343 (W.D. La. 1951).

²¹ Currie, *supra* note 19, at 49; Currie, *The Constitution and the Transitory Cause of Action*, 73 Harv. L. Rev. 36, 42 (1959); Reese, *supra* note 19, at 342; Moore and Oglebay, *The Supreme Court and Full Faith and Credit*, 29 Va. L. Rev. 557, 609 (1943); Hilpert and Cooley, *supra* note 19, at 41-43. See Stumberg, *Principles of Conflicts of Laws* 67-68 (2d ed. 1951).

²² See note 21 *supra*. It is important to remember that "Full Faith and Credit shall be given . . . to the public acts, records and judicial proceedings of every other State." U.S. Const. art. IV, § 1. This has been interpreted to mean that full faith and credit will be given to the statute-law of a sister state: *Smithsonian Institution v. S. John*, 214 U.S. 19 (1909); 62 Stat. 947 (1948), 28 U.S.C. § 1738 (1958). Moreover, there is a growing body of opinion which says that full faith and credit must also be given to the decisional law of a sister-state: Currie, *supra* note 19, at 15-16; cf. *Holderness v. Hamilton Fire Ins. Co.*, 54 F. Supp. 145 (S.D. Fla. 1944). Similarly, writers have felt that a state may deprive a party of due process by applying the common law of any state having no interest in the matter: Hilpert and Cooley, *supra* note 19, at 54-58; Currie, *supra* note 19, at 16; cf. *Young v. Masci*, 289 U.S. 253 (1933). These last two problems will not present any difficulties here, since the categories of cases to be discussed will involve only statutory law, and it is settled that due process will upset an improper application of the statutory law of the forum and full faith and credit will upset a failure to apply the properly controlling statute of a sister-state. See note 20 *supra* and note 24 *infra*.

²³ Reese and Kaufman, *supra* note 1, at 1132; Comment, *Full Faith and Credit to Statutes*, 45 Yale L.J. 339 (1935); Holt, *Full Faith and Credit—A Suggested Approach to the Problem of Recognition of Foreign Corporations*, 89 U. Pa. L. Rev. 453, 478 (1941); see Coleman, *Corporate Dividends and the Conflict of Laws*, 63 Harv. L. Rev. 433, 437-38 (1950); Jackson, *Full Faith and Credit—the Lawyer's Clause of the Constitution*, 45 Colum. L. Rev. 1, 27 (1945).

be explained on the first test.²⁴ In one area, in particular, although the courts give "lip service" to the "weighing of interests" test, it is becoming increasingly clear that the courts will allow the forum to apply its own law, simply on a showing that the forum has a sufficient interest in the transaction in question; this is in the area of workmen's compensation.²⁵

There are two other areas in which the full faith and credit clause has been applied. Neither of these is clearly explicable on the first test; that is, in both areas it would appear that the courts are first considering the legitimate concern of the forum and the sister state, as well as a national concern for uniformity; second, weighing them, and last, choosing the law representing the superior interest. In the first line of cases, it has been held that full faith and credit demands that the liability of a shareholder of a corporation for corporate debts, and the manner in which it may be enforced, are governed solely by the statutes of the state of incorporation. Such liability cannot be increased, nor a different remedy given, by the statutes of any other state in which the corporation may do business.²⁶ Unfortunately, the authority of these cases has been lessened some-

²⁴ *Pink v. A. A. Highway Express*, 314 U.S. 201 (1941); *Klaxon v. Stentor Co.*, 313 U.S. 487 (1941); *John Hancock Ins. Co. v. Yates*, 299 U.S. 178 (1936); *Metropolitan Co. v. Brownell*, 294 U.S. 580 (1935); *Clark v. Willard*, 294 U.S. 112 (1934); *Aetna Life Ins. Co. v. Dunken*, 266 U.S. 389 (1924); *Mutual Life Ins. Co. v. Leibling*, 259 U.S. 209 (1922); *Olmstead v. Olmstead*, 216 U.S. 386 (1910); *New York Life Ins. Co. v. Cravens*, 178 U.S. 389 (1900).

²⁵ In *Bradford Elec. Co. v. Clapper*, 286 U.S. 145 (1932), a New Hampshire court was compelled to give full faith and credit to a Vermont workmen's compensation act, although the injury was caused in New Hampshire. In *Alaska Packers Ass'n v. Industrial Acc. Comm'n*, 294 U.S. 532 (1935), it was held where the contract of employment was entered into in California, the injury occurring in Alaska, notwithstanding that the contract recited that the employee was to be bound by the Alaska compensation statute, that due process and full faith and credit were not violated by an application of California law. The Court (*Id.* at 547-48), however, applied a "weighing" test. *Bradford* was distinguished in *Pacific Ins. Co. v. Industrial Acc. Comm'n*, 306 U.S. 493 (1938), where it was held that California did not have to give full faith and credit to a Massachusetts compensation statute where the injury occurred in California. In *Carroll v. Lanza*, 349 U.S. 408 (1955), it was similarly held that the state where the worker was injured could award him damages although the compensation act of the state where the contract of employment was made and the parties resided purported to give an exclusive remedy. See *Watson v. Employers Liab. Corp.*, 348 U.S. 66 (1954); Mr. Currie in an examination of these cases, *supra* note 19, at 26-27, distinguishes *Bradford* from the subsequent cases by saying that the former case was one of wrongful death and the latter were cases of personal injury, and he argues that in *Bradford* New Hampshire had no interest in the application of its wrongful death statute. This effects a harmonization of this case with the first test, but it is admitted to be a "latter-day rationalization."

²⁶ *Broderick v. Rosner*, 294 U.S. 629 (1935); *Converse v. Hamilton*, 224 U.S. 243 (1912); *Leyner Engineering Works v. Kempner*, 163 Fed. 605 (S.D. Tex. 1908). See *Doggrell v. Southern Box Co.*, 208 F.2d 310 (6th Cir. 1953).

what by a series of contrary decisions permitting application of shareholder liability statutes of states other than that of incorporation.²⁷

The second line of cases has consistently held that the rights of members of a fraternal and beneficiary society must be determined by the law of the state of the society's incorporation.²⁸ These cases have been heavily criticized by those advocates of the first test;²⁹ and, it is true both that the most recent decision embodying the rule for beneficiary societies was a 5-4 decision of the Supreme Court,³⁰ and that the rule was successfully avoided by a decision in the sixth circuit.³¹ However, *Wolfe*, and the cases which it followed, are significant for the purposes of this study for this reason: they demonstrate that the Supreme Court, when faced with the problem of whether a state should be compelled to give full faith and credit to the statutes of another state, will, in certain types of transactions, consider the national concern for the application of a uniform law, and will, when the occasion calls for it, direct all states to apply that uniform law.

C. OFFERS AND SALES EFFECTED IN A STATE VIA THE MAILS

1. *The Case Law.* In *Merrick v. Halsey & Co.*³² the question presented was the validity of the Michigan blue sky law. The persons bringing the suit to enjoin the enforcement of the statute consisted

²⁷ *Thomas v. Mathiessen*, 232 U.S. 221 (1914); *Pinney v. Nelson*, 183 U.S. 144 (1901). See *Thomas v. Wentworth Hotel Co.*, 158 Cal. 275, 110 Pac. 942 (1910). In *Thomas v. Mathiessen*, supra at 235, the Court did not apply the rule that the liability of a stockholder is to be determined solely by the charter and laws of the incorporating state. The Court said that since the corporation was authorized to do business in California, the shareholder must be deemed to have given his consent to its doing business there. "He knew that California had laws and he took his risk of what they might be, when . . . he gave his assent to doing business there." *Coleman*, supra note 23, at 478, attempts to reconcile the cases on a "weighing of interests" approach:

. . . the cases are . . . consistent with the theory that a state other than that of incorporation is under a duty to give full faith and credit to the immunity from personal liability granted a shareholder by the statute of the state of incorporation, unless some interest is shown in imposing personal liability that is superior to the interest of the state of incorporation in granting immunity from such liability.

²⁸ *Order of United Commercial Travellers v. Wolfe*, 331 U.S. 586 (1947); *Sovereign Camp v. Bolin*, 305 U.S. 66 (1938); *Modern Woodman v. Mixer*, 267 U.S. 544 (1925); *Royal Arcanum v. Green*, 237 U.S. 531 (1915).

²⁹ *Currie*, supra note 19, at 49, 52, 76. Mr. Currie's main objection to an interest weighing approach is that it turns the courts into miniature legislatures. The role of the courts, he believes, should be confined to an inquiry into whether the state seeking to apply its law, has a "legitimate interest in the application of its policy." Note, *Full Faith and Credit: Preferential Treatment of Fraternal Insurers*, 57 Yale L.J. 139, 141 (1947).

³⁰ *Order of United Commercial Travellers v. Wolfe*, 331 U.S. 586 (1947).

³¹ *Order of United Commercial Travellers v. Duncan*, 221 F.2d 703 (6th Cir. 1955).

³² 242 U.S. 568 (1917).

of a considerable number of corporations, partnerships and individuals. These complainants alleged that the statute was unconstitutional as contrary to due process and to the commerce and cruel and unusual punishment clauses; and that the statute consisted of an unconstitutional delegation of power to the Michigan Securities Commission.⁸³ Among those contesting was Remick, Hodges Company, a partnership. Remick and Hodges were both residents of New York, and March, a third partner, was a resident of New Jersey. Their office was in New York City, and they were engaged in the business of buying and selling stock, bonds and other securities. They carried on business in New York and elsewhere through agents and by means of the mails. The partners had no place of business in Michigan and were not at the time of this suit sending agents into the state. However, they had been offering and were offering securities for sale to customers in the state of Michigan by mail, telegraph or telephone.⁸⁴ The Court held (Mr. Justice McReynolds dissenting) that the Michigan blue sky law was a valid exercise of the police power of the state, and was not unconstitutional under the fourteenth amendment, the commerce clause, or as an unconstitutional delegation of power.⁸⁵

No consideration was given to the special problem raised by the New York partnership. The case, therefore, amounts to a blanket validation of the Michigan blue sky law even as applied to offers effected in a state solely by use of the mails or other interstate facilities. Although the Court did not give any special attention to this transaction, it was believed by a number of practitioners at that time, that the Court definitely meant what it was saying. For example, the opinion of counsel, referred to above,⁸⁶ states:

Our conclusion on this point, therefore, is that if the Blue Sky Laws were constitutional in their entirety and as they seem to be construed by the State officials, the offering of securities by mail or telegraph, or even by telephone, from outside the State would constitute a violation of the law and be indictable and punishable as such in the State.⁸⁷

⁸³ *Id.* at 570-71.

⁸⁴ *Id.* at 572-73. See opinion delivered to the Investment Bankers Association of America, by its counsel, Reed & McCook of New York, in Elliott, *The Annotated Blue Sky Laws of the United States* 34-44 (1919), and in Reed & Washburn, *Blue Sky Laws, Analysis and Text* 255a-67a (1921).

⁸⁵ *Id.* at 589-90. See note 16 *supra* on the special problem raised by the commerce clause.

⁸⁶ See note 34 *supra*.

⁸⁷ Elliott, *op. cit.* *supra* note 34, at 38.

The opinion also refers to the problem of advertisements:

The conclusion above stated necessarily applies to advertisements in papers published in the Blue Sky State, the papers being in legal effect a medium through which the offering is made to the investor. It would seem also to apply though with *manifest difficulties* in its application, to advertisements in papers or magazines published in other States and circulating in the Blue Sky States. We say with manifest difficulties in its application, because in a criminal prosecution it would, we hope, be impossible to convict a dealer for an advertisement in a Springfield, Illinois, paper a few copies of which without his knowledge, in intent, found their way into Iowa. On the other hand, an advertisement in a Chicago paper made with knowledge of its wide circulation in Michigan . . . would seem to constitute an intended offering of the security in those states, as would also an advertisement in a national magazine known to circulate in all or most of the states.³⁸

*Wrigley Pharmaceutical Co. v. Cameron*³⁹ was decided nine years later. The plaintiff in that case was a Delaware corporation with an office in Atlantic City, New Jersey. The president of the corporation was a citizen of Pennsylvania and an inhabitant of Philadelphia. The defendants were the commissioner of banking and the attorney general of Pennsylvania. Wrigley had been engaged in the sale of tooth paste and treasury stock to inhabitants of Pennsylvania by use of circulars sent through the mails from Atlantic City to the Pennsyl-

³⁸ Ibid.

³⁹ 16 F.2d 290 (M.D. Pa. 1926); Klagsbrunn, Regulation of Interstate Security Sales—A Recent Report, 1 U. Chi. L. Rev. 88, 89 (1933). See also *Duke v. Olson*, 240 Ill. App. 198 (1926). This was a suit brought to enforce double liability of a stockholder of a bank under a Washington statute. The defendant contended, *inter alia*, that the stock was sold to him in violation of the blue sky law of Illinois. The facts were that one J saw a circular in his office at Chicago, soliciting sales of securities, inquiries to be directed to Tacoma, Washington. J induced the defendant to buy, defendant agreed, and J wired the bank for fifteen shares (five for himself and ten for defendant). The bank acknowledged receipt and sent subscription blanks to J. J was not an agent of the bank. The court merely said, as to this point, "Under similar circumstances, it was held that there was no violation of the Blue Sky Law. *People v. Hill Top Metals Min. Co.*, 300 Ill. 564." Id. at 206. An examination of *People ex rel. Brundage v. Hill Top Metal Mining Co.*, 300 Ill. 564, 133 N.E. 303 (1921), indicates that the court in *Duke* treated this transaction as a sale made in Washington; and, on the majority view that the validity of a contract is determined by the law of the place of contracting, Illinois law was inapplicable; it was merely the place where the sale was solicited. The court is not saying, however, that an offer to sell securities directed into Illinois would not be a violation of the statute, even though via the mails.

vania residents. When the commissioner of banking issued a subpoena to the president and vice-president, requiring their presence for an examination pursuant to the Pennsylvania securities law, the officers refused to appear, and instead filed a bill to restrain the defendants from prosecuting any civil or criminal action under the statute because it was in violation of the commerce clause of the Constitution.⁴⁰ The court dismissed the action as premature, for the reason that it was impossible to determine that it was the intention of the authorities of Pennsylvania to undertake any direct interference with interstate commerce.⁴¹ However, the court did express itself on how it would probably treat the case, if it were not premature. Citing *Merrick*, it said that "... it is clear that the Pennsylvania Securities Act cannot be attacked on the ground that it is an unlawful interference with interstate commerce."⁴²

This case is vulnerable for three reasons: (1) the statement of the court as to the constitutionality of the statute amounts only to a dictum; (2) it is not entirely clear from the opinion whether the mail order business was carried on solely via the mails (the president and vice-president were both citizens of Pennsylvania); (3) the court, as in *Merrick*, did not address itself to the specific problem of offers effected in the state solely via the mails. However, the implication of the decision is that the statute covered this type of transaction (assuming it was carried on solely via the mails), and that there was no constitutional objection. •

Then in *Bartlett v. Doherty*,⁴³ the court dealt separately with two transactions. In the first transaction, the plaintiffs had given orders in New Hampshire for the purchase of stock from the defendant, having been solicited by an agent of the defendant who was physically in the state. In the second transaction one of the plaintiffs, Bartlett, called the defendant's Boston office by telephone for information concerning some stock previously purchased. The call was referred to the New Hampshire agent who at that time was present in the Boston office. The agent urged Bartlett to buy more stock. The plaintiff agreed and mailed a check to the Boston office. The stock was delivered and accepted by the plaintiff in New Hampshire.⁴⁴ The action arose when the plaintiffs sought to recover money paid for the stocks which they alleged were sold in violation of the New Hamp-

⁴⁰ 16 F.2d at 291.

⁴¹ *Id.* at 296.

⁴² *Ibid.*

⁴³ 10 F. Supp. 465 (D. N.H. 1935), *aff'd* in part and *rev'd* in part, 81 F.2d 920 (1st Cir.), *cert. denied* sub nom. *Doherty v. Knowlton*, 298 U.S. 676 (1936).

⁴⁴ 81 F.2d at 921-22.

shire blue sky law. That law provided: "No salesman or agent shall *in this state*, in behalf of any dealer, sell, offer for sale or invite offers for or inquiries about securities unless registered. . . ." ⁴⁵ (Emphasis added.) It was alleged that the New Hampshire agent was not registered. The district court decided in favor of the plaintiffs in each case and the defendants appealed.

As to the first transaction the court affirmed the decision of the district court. The court said that: "If an unregistered salesman or agent sold or took orders for stock in violation of such statutes and his illegal acts cannot be ratified by his principal, a purchaser, on offering to return his stock and any benefit received therefrom, is entitled to recover the purchase price."⁴⁶ However, the court reversed the district court and held that the second transaction was not covered by the securities act. The court said:

No act of Parent, either of solicitation or offer of sale, took place in New Hampshire. No contract of sale, even if Parent was authorized to make a contract of sale, was entered into by him while in New Hampshire. He violated no provision of the New Hampshire law by soliciting a sale in Massachusetts, where he was duly registered and authorized to solicit a sale of securities as a representative of the defendant, Doherty.⁴⁷

The decision seems to indicate that to be a violation of the statute there must be an offer or sale *in New Hampshire*. There was an offer in this case, but that offer, the court held, was made in Massachusetts, not in New Hampshire. This interpretation of the law runs counter to the view that a proposal is not an "offer" until it is received.⁴⁸ The view that the proposal is not an offer until receipt points to the place of receipt as the place where the offer is "made."⁴⁹ But here we are left with a rather strict interpretation of the statute; that is, an offer can only be made in New Hampshire when the offeror is physically present in that state. The court said that "*no contract of sale . . . was entered into by (the agent) while in New Hampshire.*"⁵⁰

⁴⁵ See N.H. Rev. Stat. Ann. § 421:18 (1955), which makes the provision as stated in the text. It was admitted that the defendant was registered as a dealer under the statute. See N.H. Rev. Stat. Ann. § 421:7 (1955).

⁴⁶ 81 F.2d at 927.

⁴⁷ *Id.* at 928.

⁴⁸ Restatement, Contracts § 23 (1932).

⁴⁹ The Uniform Securities Act § 414(c) solves the problem by saying that an offer is "made in this state" either if it "originates from this state" or if it "is directed by the offeror to this state."

⁵⁰ 81 F.2d at 928.

(Emphasis added.) Thus, the statutory phrase "in this state," not only modifies "... sell, offer for sale ..." but also "... salesman or agent ..." so that in order to violate the New Hampshire statute a salesman must actually enter the state and carry on his negotiations there.⁵¹

It must be remembered that this is a federal court decision construing the New Hampshire statute. Even if New Hampshire still places this restrictive interpretation on her blue sky law—binding only those defendants who make sales or offers when physically present in the state—this does not mean that a broader interpretation would be unconstitutional. There is no indication in the case that the court was interpreting the statute so as to make it constitutional.

Before turning to the leading case on this subject, reference might be made to *Hardy v. Musicraft Records, Inc.*⁵² In that case, the plaintiff, at his Los Angeles residence, received a letter forwarded from New York from the predecessor of the defendant corporation. The letter enclosed a purchase commitment letter for the plaintiff's use in confirming an agreement to buy shares of the predecessor corporation. The plaintiff signed the purchase commitment letter and sent it by mail from Los Angeles to the corporation in New York. Certificates representing 5,000 shares in the corporation were forwarded from New York to the California Bank in Los Angeles and were eventually delivered to the plaintiff. When the plaintiff discovered that no permit had been procured by the corporation for the sale of its shares, this action was brought to recover the purchase price.⁵³ The court held that since the contract was made in California by mailing the purchase commitment letter there, the validity of that contract was governed by California law. The California statute, as it then provided, stated that: "Every security issued by any company without a permit of the commissioner authorizing the same then in

⁵¹ Two points should be kept in mind: first, whether the words "in this state" appear in the statute, or not, any offer or sale which does not occur within the state cannot be constitutionally regulated by a statute of that state; at least in this sense a statute can have no extra-territorial effect. See, e.g., *People v. J. O. Beckman & Co.*, 347 Ill. 92, 97, 179 N.E. 435, 437 (1932). This proposition will be examined more fully in connection with the second category of transactions to be analyzed. It is only necessary here to point out that while in *Merrick* it was both assumed that the offers via the mails occurred within the state and that the statute covered those offers, and held that the statute was constitutional, in *Doherty* it was held that the offer did not occur within the state, and hence, was not covered by the statute. Second, most of the blue sky laws contain the phrase "in this state," but, as will be seen, the majority of blue sky administrators do not imply the same physical presence qualification into their provisions as did the *Doherty* court into the New Hampshire statute.

⁵² 93 Cal. App. 2d 698, 209 P.2d 839 (1949).

⁵³ *Id.* at 700, 209 P.2d at 840.

effect, shall be void."⁵⁴ The court then said that since the sale was made in violation of the statute the transaction was void and the plaintiffs were entitled to recover their money.⁵⁵ This is another decision following *Merrick* but without a reasoned opinion.⁵⁶

The discussion of the case law on this subject ends with *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n.*⁵⁷ The following is a statement of facts:⁵⁸

The appellant Traveller's Health Association was incorporated in Nebraska as a nonprofit membership association in 1904. Since that time its only office has been located in Omaha, from which it has conducted a mail-order health insurance business. New members pay an initiation fee and obligate themselves to pay periodic assessments at the Omaha office. The funds so solicited are used for operating expenses and sick benefits to members. The Association has no paid agents; its new members are usually obtained through the unpaid activities of those already members, who are encouraged to recommend the Association to friends and submit their names to the home office. The appellant Pratt

⁵⁴ Cal. Corp. Code § 26100 now provides: "Every security of its own issue sold or issued by any company without a permit is void." In spite of the language which is found in the cases that stock issued in violation of the securities act is "void," it is well settled that such securities are merely voidable at the behest of innocent purchasers or subsequent assignees: *Eberhard v. Pacific Northwest Loan & Mortgage Corp.*, 215 Cal. 226, 9 P.2d 302 (1932); *Robbins v. Pacific Eastern Corp.*, 8 Cal. 2d 241, 65 P.2d 42 (1937); *Western Oil & Ref. Co. v. Venago Oil Corp.*, 218 Cal. 733, 24 P.2d 971 (1933); *Braunstein v. Title Guar. & Trust Co.*, 216 Cal. 780, 17 P.2d 104 (1932); *Dahlquist*, 'Regulation and Civil Liability Under the California Corporate Securities Act: II, 34 Calif. L. Rev. 344, 352-53 (1946).

⁵⁵ *Hardy v. Musicraft Records, Inc.*, 93 Cal. App. 2d 698, 703, 209 P.2d 839, 842 (1949).

⁵⁶ Mention may be made of a point which is often overlooked in discussing *B. C. Turf & Country Club, Ltd. v. Daugherty*, 94 Cal. App. 2d 320, 210 P.2d 760 (1949), a proceeding to compel the commissioner of corporations to rescind an order directing petitioner, a Canadian corporation, to cease and desist from further sale of stock within the state. The decisive question was whether there was a solicitation of a sale in violation of the California statute. The court laid heavy stress on certain incidents which in their view did not amount to "solicitation." However, they ignored an incident which occurred after the plan to sell stock had been put into operation: "A Mr. Gilmore, a client of Fraser's [the principal promoter] telephoned Fraser [who was in Canada] from San Francisco and asked about the deal, and was told by Fraser about the procedure to be followed." *Id.* at 325, 210 P.2d at 763. Was the court treating this as *de minimis*, or is something being said about the application of the California statute?

⁵⁷ 188 Va. 877, 51 S.E.2d 263 (1949) [Comment, 59 Yale L.J. 360 (1950); Note, 17 U. Chi. L. Rev. 382 (1950)], *aff'd*, 339 U.S. 643 (1950); Notes, 39 Calif. L. Rev. 152 (1951), 64 Harv. L. Rev. 482 (1951); Comment, 49 Mich. L. Rev. 881 (1951); Recent Case, 99 U. Pa. L. Rev. 245 (1950).

⁵⁸ 339 U.S. at 645-46.

in Omaha mails solicitations to these prospects. He encloses blank applications which, if signed and returned to the home office with the required fee, usually result in election of applicants as members. Certificates are then mailed, subject to return within 10 days if not satisfactory. Traveller's has solicited Virginia members in this manner since 1904, and has caused many sick benefit claims to be investigated. When these proceedings were instituted it had approximately 800 Virginia members.

The Virginia Corporation Commission, determining that the activities of Traveller's violated the state blue sky law—requiring those selling or offering securities to obtain a permit—instituted cease and desist proceedings against the insurance company and its treasurer.⁵⁹

The Virginia court first asked whether "the activities of the appellants in the Commonwealth of Virginia have been such as to subject them to the State's regulatory power."⁶⁰ The court stressed the following activities taking place in Virginia: solicitation of new members by old members, investigations, remittances in payment of benefit claims being received and accepted in the Commonwealth, and the sales actually being made there. If the court had continued along this line of inquiry, a more satisfactory reasoning for the result might have been obtained. Unfortunately, the court mixed the question of the power to regulate with the power to enforce, and it did not carefully segregate its authorities under one or the other of the two issues.⁶¹ However, despite this, the court did make a clear statement of its holding:

We hold, in view of the authorities referred to, that the evidence in possession of the State Corporation Commission constituted good cause to conclude that the appellants had been engaged in selling securities in Virginia through the United States mail without complying with, and in violation of, the provisions of the applicable laws of the state.⁶²

It is assumed that the offers or solicitations made by the association

⁵⁹ Id. at 646.

⁶⁰ 188 Va. at 885, 51 S.E.2d at 265.

⁶¹ For example, the court, in seeking to refute appellant's argument that the "association is not engaged in business activities in Virginia such as to bring them within the jurisdiction of the courts of this state," and to distinguish *Minnesota Commercial Men's Ass'n v. Benn*, 261 U.S. 140 (1923) (a case dealing with whether an association was doing business in Montana for purposes of substituted service), cited a service of process case, and then cited *Merrick*, for the proposition that a state may regulate sales of securities through the mails. Id. at 888-89, 51 S.E.2d at 267-68.

⁶² Id. at 892, 51 S.E.2d at 269.

occurred within Virginia (contrary to the *Doherty* approach). The court held that the sales occurred within Virginia, and apparently that these acts within Virginia constituted violations of the blue sky law.

The opinion of the Supreme Court, delivered by Mr. Justice Black, is unsatisfactory for the same reason noted above with respect to the Virginia decision. The Court said that the basic contention ". . . is that all their activities take place in Nebraska and that consequently Virginia has no power to reach them in cease and desist proceedings to *enforce* any part of its regulatory law."⁶³ (Emphasis added.) However, the Court went on to speak of what constitutes "doing business" justifying *regulation*, and cited *Osborn v. Oslin*,⁶⁴ and *Hoopston Co. v. Cullen*,⁶⁵ distinguishing *Minnesota Ass'n v. Benn*,⁶⁶ for the proposition that ". . . a state's power to *regulate* need not be determined by a 'conceptualistic discussion of theories of the place of contracting or of performance.'"⁶⁷ Yet, at the same time the Court cites the landmark, substituted service case of *International Shoe Co. v. Washington*,⁶⁸ and lumping all these cases together the Court concludes that ". . . the contacts and ties of appellants with Virginia residents, together with that state's interest in faithful observance of the certificate obligations, justify *subjecting appellants to cease and desist proceedings under § 6*."⁶⁹ (Emphasis added.) Further, the Court says: "We hold that Virginia's *subjection* of this Association to the jurisdiction of that State's Corporation Commission in a § 6 proceeding is consistent with 'fair play and substantial

⁶³ 339 U.S. at 646-47.

⁶⁴ 310 U.S. 53 (1940), where the Supreme Court upheld a Virginia statute which provided that as to casualty and surety risks in Virginia, insured against by corporations authorized to do business in that state, the insurance shall be through regularly constituted and registered resident agents or agencies of such companies.

⁶⁵ 318 U.S. 313 (1943). The question was whether a reciprocal insurance association which insured against fire and related risks might be constitutionally made subject to a New York registration law. Except for the possibility that agents might be used to investigate risks in New York, the business of the company was carried on through the mails. The Court held that the statute was valid and not unconstitutional under the Fourteenth Amendment. This case is distinguishable from *Traveller's* on the ground that, among other things, the insurance covered property situated in New York, and the Court said that, "the states have long had great authority over property within their borders." 318 U.S. at 318. On the other hand, this is a case involving regulation and not enforcement, and it does indicate how far the courts are willing to go in permitting the states to regulate business carried on via the mails.

⁶⁶ 261 U.S. 140. See note 61 *supra*.

⁶⁷ 339 U.S. at 648.

⁶⁸ 326 U.S. 310 (1945).

⁶⁹ 339 U.S. at 648.

justice,' and is not offensive to the Due Process Clause."⁷⁰ (Emphasis added.)

The opinion indicates that these solicitations and sales occurred within Virginia. It is assumed that the Virginia blue sky law, as construed, covers these transactions. Further, it is assumed—in view of the fact that the opinion stresses the power to enforce to such an extent—that Virginia constitutionally (presumably under the due process clause) has the power to regulate these transactions. The thrust of the opinion seems directed at disposing of the constitutional objections to the ability to enforce such power as Virginia is assumed to have.

Mr. Justice Douglas, in a separate concurring opinion, said that: "The requirements of due process do not, in my opinion, preclude the extension of Virginia's regulatory scheme to appellant."⁷¹ Furthermore, he disposed of the objection based on the case where a policyholder seeks to sue the foreign company in Virginia: "His ability to sue is not necessarily the measure of Virginia's power to regulate."⁷² He said that: "Whether such solicitation is isolated or continuous, it is activity which Virginia can regulate."⁷³ Hence, Mr. Justice Douglas held that it was not a violation of due process for Virginia to regulate sales and offers made within the state via the mails.

Mr. Justice Minton, joined by Mr. Justice Jackson, dissented on the ground that the appeal was premature.⁷⁴ He said: "I would answer the question of due process when Virginia has attempted to apply its process to appellants in a proceeding that has consequence of a nature which entitles a person to the protection of the Due Process Clause."⁷⁵ However, he voiced an opinion as to the matter of substituted service, and said that for such purpose, he would not hold that appellants were "present" in Virginia. He made it clear, however, that he was discussing the power to enforce and not the power to regulate.⁷⁶ Mr. Justice Reed and Mr. Justice Frankfurter, agreed with the Court in reaching the merits, and on the merits joined the dissent.⁷⁷

The case is not satisfactory for a number of reasons: (1) as has

⁷⁰ Id. at 649.

⁷¹ Id. at 652.

⁷² Id. at 653. This distinction was also drawn in the Virginia court, where an attempt was made to distinguish the *Benn* case, which involved a "pecuniary civil judgment," and *Traveller's*, which was an inquiry "quasi-criminal in its approach." 188 Va. at 889, 51 S.E.2d at 267.

⁷³ 339 U.S. at 654.

⁷⁴ Id. at 655.

⁷⁵ Id. at 657.

⁷⁶ See note 8 *supra*.

⁷⁷ 339 U.S. at 659.

been noted throughout the discussion of the case, the problem of regulation and enforcement are lumped together; (2) possibly the decision only represents that line of cases recognizing the state's special interest in regulating the insurance business;⁷⁸ (3) there may be some factual distinctions, such as the fact that the association relied on the activities of old members to solicit new members or the fact that investigations might be made in Virginia by the company. The Supreme Court opinion, nevertheless, is strong authority for the proposition that when an individual or corporation does a substantial amount of business in the state, then that state has the power at least under the due process clause to regulate offers and sales made within the state, effected by the use of interstate facilities.

2. *Administrative Opinions.* A number of attorney general opinions have been written on the issue of whether the particular blue sky law in question was broad enough to cover an offer or sale effected in the state solely by use of the mails. Those opinions vary, and many of them probably do not represent current thinking among the present securities commissioners and administrators.⁷⁹ Perhaps a more realistic indication of how blue sky law administrators construe their statutes was obtained by a private survey conducted by the author. The following questionnaire was sent to forty-eight administrators:⁸⁰

- A. Do you believe that your Blue Sky Law is broad enough to cover an offer or sale (or both) of securities in your state,

⁷⁸ "In *Osborn v. Ozlin* . . . we recognized that a state has a legitimate interest in all insurance policies protecting its residents against risks, an interest which the state can protect even though the 'state action may have repercussions beyond state lines. . . .'" *Id.* at 647.

⁷⁹ In *Ops. Ohio Att'y Gen.* 1423 (1935), it was thought that newspapers published out of state containing advertisements of securities did not violate the statute, and in *Ops. Ore. Att'y Gen.* 688 (1940), it was said that where Oregon residents address inquiries about stocks to a New York corporation and where negotiations are carried on through the mails culminating in a sale in New York, the New York corporation is not violating the Oregon act. In *Ops. Conn. Att'y Gen.* 350 (1932), the writer believed that a broker located out of state, offering or selling securities to persons located within the state, solely via the mails was subject to the securities act. The New Mexico Attorney General, *Ops. N.M. Att'y Gen.* 38 (1933), although believing that sales via the mails within the state were "technical" violations of the statute, did not believe that the state could exercise effective control over these transactions. An earlier opinion in *Ops. Mich. Att'y Gen.* 621 (1955), was overruled in a later opinion in *Ops. Mich. Att'y Gen.* 465 (1957), where it was held that non-resident dealers or brokers might not legally solicit persons in Michigan by mails without being licensed as a securities dealer under the Michigan blue sky law. A position similar to that of the Michigan Attorney General was taken in 23 *Ops. Md. Att'y Gen.* 138 (1938), and in 17 *Ops. Cal. Att'y Gen.* 217 (1951).

⁸⁰ Delaware and Nevada, which have no blue sky laws, excepted. All correspondence and other data relating to this survey are on file in Harvard Law Library.

solely via the mails or some interstate facility, by a person in another state?

- B. This question covers not only the case of the individual contract, but also the situation involving advertisements from out-of-state newspapers, radio and television stations and the like. Whatever your answer, it would be helpful if the section or sections upon which you rely were cited.

Replies were received from forty-two states. Five states to date have solved the problem by adopting Section 414 of the Uniform Securities Act.⁸¹ Twenty-six state administrators answered "yes" to the entire question, and of those twenty-six, sixteen referred to specific sections of their statutes.⁸² Four administrators believe that the answer to part "A" is "yes," but that their respective statutes do not cover the case of out-of-state newspapers, radio and the like. Again, of those four, three referred to specific sections of their statutes.⁸³ Seven administrators answered "no" to the entire question, and four of the answers pointed to particular sections of their codes.⁸⁴ The Iowa administrator believed that although the act seemed broad enough to cover interstate solicitations and sales, there was considerable doubt about the ability to enforce such violations.⁸⁵ As the North Dakota statute relating to securities registration uses the words "offer to sell,"⁸⁶ and the dealer section reads, "No dealer or salesman

⁸¹ Alaska Comp. Laws Ann. § 35-6-34 (Supp. 1959); Ark. Stat. Ann. § 67-1260 (Supp. 1961); N.J. Stat. Ann. § 49-3-4 (Supp. 1961); Okla. Stat. Ann. tit. 71, §§ 2(c), 2(f), 2(j)(2), 413 (Supp. 1961); S.C. Acts 1961, Blue Sky L. Rep. ¶ 43,226.

⁸² Cal. Corp. Code §§ 25009, 25500 (as amended, Cal. Stats. 1961, ch. 1574, § 1); Colo. Rev. Stat. Ann. § 125-1-3(2) (Supp. 1960); Fla. Stat. Ann. § 517.02(3) (Supp. 1961); Ill. Ann. Stat. ch. 121 1/2, § 137.10 (Smith-Hurd 1960); Ind. Ann. Stat. §§ 25-830, 25-831(c) (1960) [since repealed as the Uniform Securities Act was adopted (effective July, 1961), Ind. Ann. Stat. §§ 25-854 to 876]; Kan. Gen. Stat. Ann. §§ 17-1254, 17-1255, 17-1265 (Supp. 1961); La. Rev. Stat. § 51:701(3) (1950); Mass. Gen. Laws Ann. ch. 110A, § 5 (1958); Minn. Stat. Ann. §§ 80.01(3), 80.18 (Supp. 1959); Neb. Rev. Stat. § 81-304 (1958); N.J. Stat. Ann. § 49:1-4 (1955) [since repealed as the Uniform Securities Act was adopted (effective January, 1961), N.J. Stat. Ann. § 49-3-4 (Supp. 1961)]; N.Y. Gen. Bus. Law § 352-G; Pa. Stat. Ann. tit. 70, § 32(b) (Supp. 1961); Tenn. Code Ann. § 48-1602(F) (Supp. 1961); Wash. Rev. Code § 21.20.005(9) (Supp. 1960) [amended, and now appears in § 21.20.005(10) (Supp. 1961)]; Wyo. Stat. Ann. § 17-103 (1957); Ala., Ga., Md., Miss., Mo., N.M., Ore., R.I., Tex., Wis.

⁸³ Hawaii Rev. Laws §§ 199-6, 199-11, 199-16, 199-17, 199-20 (1955); Utah Code Ann. § 61-1-4(3) (1953); Vt. Stat. Ann. tit. 9, §§ 4202, 4205, 4213, 4224 (1958); Ohio.

⁸⁴ Idaho Code §§ 26-1801, 26-1815 (1947); Rev. Stat. Me. Ann. ch. 59, § 228 (1959); W. Va. Code § 3273(12) (1955); Ariz., Conn., S.D., S.C.

⁸⁵ Letter from C. L. Hughes, Securities Commissioner, to the author, March 21, 1960.

⁸⁶ N.D. Rev. Code § 10.0404 (Supp. 1957), as amended, N.D. Laws 1961, H.B. 921, § 2.

shall offer for sale or sell any securities . . ."⁸⁷ the North Dakota blue sky administrator would answer "yes" to both parts of the question, but only as to out-of-state newspapers having a "substantial circulation" in the state, and television offers.⁸⁸

The results, then, suggest that a large majority of the administrators are in favor of a construction of their statutes which would first, indicate that offers directed into the regulating state are made in that state,⁸⁹ and second, that the offers and sales so made in the state are covered by their blue sky laws.

D. CONCLUSION

There are a number of analogies which can be and have been drawn in support of the state's power to regulate offers and sales of securities.⁹⁰ Perhaps, though, the problem is not as troublesome as it once was. In the first place, there is the problem of where the offer was made. All but one of the cases in this area have assumed that where the offer is made via the mails or the telephone, it was made in the state where it was received. It is submitted that *Doherty* may be distinguished in future cases, possibly on the ground that it was the customer, and not the broker, who took the initiative in that case. Second, while nearly no state blue sky law expressly so provides (with the exception of those states which have adopted Section 414 of the Uniform Securities Act), the cases appear to either assume,⁹¹ or hold,⁹² that such offers or sales made within the state come within

⁸⁷ N.D. Rev. Code § 10.0410 (Supp. 1957), as amended, N.D. Laws 1961, H.B. 921, § 9.

⁸⁸ Letter from C. L. Hughes to the author, March 21, 1960.

⁸⁹ Both the Michigan and the Texas administrators expressed agreement with this proposition. Letter from C. Hayes, Assistant Commissioner, to the author, March 23, 1960, and Letter from W. King, Securities Commissioner, to the author, Jan. 28, 1960.

⁹⁰ Loss & Cowett, *Blue Sky Law* 215-21 (1958). For example, the authors point to the criminal law analogies: it is generally held, assuming that the facts otherwise disclose an offense committed within the jurisdiction, that the court is not deprived of jurisdiction by mere absence of the defendant from the state at the time the offense was committed: *Ford v. United States*, 273 U.S. 593 (1927); *Lamar v. United States*, 240 U.S. 60 (1916); *Strassheim v. Dailey*, 221 U.S. 280 (1911); *In re Palliser*, 136 U.S. 257 (1890); *United States v. Steinberg*, 62 F.2d 77 (2d Cir. 1932), cert. denied, 289 U.S. 729 (1933); *Ex parte Hedley*, 31 Cal. 108 (1866); *State v. Tickle*, 238 N.C. 206, 77 S.E.2d 632 (1953), cert. denied, 346 U.S. 938 (1954). See also *Restatement (Second), Conflict of Laws* § 43F(1)(e), comment at 30 (Tent. Draft No. 3, 1956). In the law of torts, the conflicts principle is that the court must look to the law of the state where the last event necessary for liability takes place: *Aetna Freight Lines v. R. C. Tway Co.*, 298 S.W.2d 293 (Ky. 1956); *Restatement, Conflict of Laws* §§ 377-79 (1934).

⁹¹ *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 339 U.S. 643 (1950); *Merrick v. N. W. Halsey & Co.*, 242 U.S. 568 (1917); *Wrigley Pharmaceutical Co. v. Cameron*, 16 F.2d 290 (M.D. Pa. 1926); *Hardy v. Musicraft Records, Inc.*, 93 Cal. App. 2d 698, 209 P.2d 839 (1949).

⁹² *Traveller's Health Ass'n v. Commonwealth of Virginia ex rel. State Corp. Comm'n*, 188 Va. 877, 51 S.E.2d 263 (1949).

the purview of that state's securities law. Third, while none of the cases above raised the point, it seems clear that the offering and selling of stock by a foreign corporation within a state does not come under the so-called "internal affairs" rule,⁹³ a rule which says that a state has no "visitorial" powers over foreign corporations and that its courts will not interfere in their internal affairs and management.⁹⁴

Last is the constitutional issue. In spite of the uncertainties which might still exist on this question, it is submitted that today there are no constitutional objections where a state seeks to regulate interstate solicitations and sales, made within its boundaries. If a straight "governmental interest" test is adopted, that test appears to be satisfied. It is well settled that a state has a sufficient concern to protect its citizenry from "speculative schemes which have no more basis than so many feet of 'blue sky'" or "to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines and other like fraudulent exploitations."⁹⁵ Moreover, it does not seem likely that, even on the "weighing of interest" test, a different result would be reached. There does not seem to be any need for the application of a single law in this instance. It has been suggested that there is no reason why, when a corporation is performing an act that an individual is also capable of performing (*e.g.*, offering and selling stock to the public), the purchaser's rights ought not to vary depending on the state in which he deals with the corporation.⁹⁶

Therefore, if the proposition is accepted that a state has a sufficient interest in the protection of its citizens with respect to stock schemes, that interest ought constitutionally to support its regulating offers and sales via the mails; and, logically, that power ought to extend even to the case of the single offer, or the isolated sale, no matter what the

⁹³ *London, Paris & American Bank v. Aronstein*, 117 Fed. 601, 609 (9th Cir.), cert. denied, 187 U.S. 641 (1902):

It is true the courts in California cannot control the internal affairs of any foreign corporation. Such matters are to be conducted in pursuance of and in compliance with the provisions of the charter of the foreign corporation, and the laws of the country where it was created; but in the management and method of its business affairs in California with the citizens and residents thereof, *in the sale or disposition or transfer of the shares of stock, it must conform* to the laws of California in relation to such matters . . . (Emphasis added.)

See also *Williams v. Gaylord*, 186 U.S. 157 (1902); *Gillis v. Pan American W. Petroleum Co.*, 3 Cal. 2d 294, 44 P.2d 311 (1935); *Biddle v. Smith*, 148 Tenn. 489, 256 S.W. 453 (1923).

⁹⁴ See, *e.g.*, *Kelly v. American Sugar Ref. Co.*, 139 F.2d 76 (1st Cir. 1943), cert. denied, 321 U.S. 791 (1944).

⁹⁵ *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917).

⁹⁶ Reese and Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 Colum. L. Rev. 1118, 1124 (1958).

medium may happen to be.⁹⁷ As the survey shows, a great majority of the state administrators construe their statutes to reach these limits. In considering this proffered opinion, however, it might be remembered that the Supreme Court has only sustained statutes in the cases of companies which carried on a *continuous* selling effort in the regulating state.

1. *The Uniform Securities Act.*⁹⁸ The act, in section 414, provides that an offer is "made in this state" both when the offer "originates from this state" or "is directed by the offeror to this state."⁹⁹ This solves the uncertainty of the question of where the offer is "made," pointed up especially by *Doherty*. The section puts a special emphasis on the interest of the individual in compliability and fairness, when it excludes from its definition of "offer" newspapers published outside the state, and radio and television programs originating outside the state.¹⁰⁰ However, it is still possible for the newspaper or the television station to violate the statute if it accepts an "offer to buy"—made as a result of the advertisement—"in this state."¹⁰¹ The section represents a maximizing both of the state's interest in regulation and protection, and the individual's interest in certainty and a "just" application of the law.¹⁰²

II. THE WESTERN AIR LINES CASE

A. THE STATUTORY BACKGROUND

Section 25500 of the California Code¹⁰³ provides that "no company shall sell any security of its own issue . . . or offer for sale, negotiate for the sale of, or take subscriptions for any such security, until it has first applied for and secured from the commissioner a

⁹⁷ The case of *Hardy v. Musicraft Records, Inc.*, 93 Cal. App. 2d 698, 209 P.2d 839 (1949), which appears to be an instance of an isolated sale, may support this proposition.

⁹⁸ *Loss & Cowett*, op. cit. supra note 90, at 224-29.

⁹⁹ Section 414(c).

¹⁰⁰ Section 414(e).

¹⁰¹ Section 414(d).

¹⁰² See Uniform Securities Act § 401(c)(4) which excludes from the definition of "Broker-Dealer" any person "who has no place of business in this state if . . . during any period of twelve consecutive months he does not direct more than fifteen offers to sell or buy into this state . . . whether or not the offeror or any of the offerees is then present in this state," and § 401(f)(6) which makes the same exclusion for "Investment adviser," fixing the number at five, instead of fifteen, and using the term "business communications" instead of "offers to sell or buy." These two sections have been adopted by: Alaska Comp. Laws Ann. §§ 35-6-21(c), 35-6-21(f) (Supp. 1959); Ark. Stat. §§ 67-1247(c), 67-1247(f) (Supp. 1961); Hawaii Rev. Laws §§ 199-1(c), 199-1(f) (1955); Okla. Stat. Ann. §§ 2(c), 2(f) (Supp. 1961). Code Va. § 13.1-501(c) (1950), adopts with some changes § 401(c); and N.M. Stat. § 48-18-17(h) (Supp. 1961) adopts with only a slight change § 401(f).

¹⁰³ Cal. Corp. Code § 25500.

permit authorizing it so to do." Section 25003(a) expressly defines "company" to include all domestic and foreign corporations. Section 25009 defines "sale" or "sell" as including all of the following: ". . . every disposition or attempt to dispose of a security or interest in a security for value . . . an offer to sell; an attempt to sell; a solicitation of a sale; an option of sale; a contract of sale; a taking of a subscription; *an exchange; any change in the rights, preferences, privileges or restrictions on outstanding securities.* . . ." (Emphasis added.) This last section, beginning with "any change," was added in 1945. Prior to that time, the practice had been to bring cases of "changes in rights, preferences, etc." under the heading of "exchange."¹⁰⁴ The wording of the 1945 amendment encompasses those "changes in rights" which are brought about by amendments to the charter; but as the words of the statute are not limited to that case alone, the section might conceivably include "changes" brought about by amendments to the by-laws, or possibly by resolutions of shareholders or directors. In enforcing these provisions of its code, California has been concentrating in the area of "changes" brought about by charter amendments, but what shall be said about this area of enforcement applies equally to the case of by-law or resolution "changes" as respects the constitutionality of California regulation.

Section 25507 provides for the issuance of a permit "authorizing it to issue and dispose of securities" if the commissioner finds that:

. . . the proposed plan of business of the applicant and the proposed issuance of securities are fair, just and equitable . . . that the applicant intends to conduct its business fairly and honestly . . . and that the securities that it proposes to issue and the method to be used by it in issuing or disposing of them are not such as, in his opinion, will work a fraud upon the purchaser thereof. . . .

Section 25510, applying specifically to the case of "exchanges" of securities, and a bit more burdensome than section 25507, provides:

When application is made for a permit to issue securities in *exchange* for one or more bona fide outstanding securities . . . the Commissioner is and has been authorized to approve the terms and conditions of such issuance and exchange and the fairness of such terms and conditions, after a hearing upon the fairness of such terms and conditions, at which all persons to whom it is proposed to issue securities

¹⁰⁴ Dahlquist, Regulation and Civil Liability Under the California Corporate Securities Act: II, 34 Calif. L. Rev. 344, 350-59 (1946).

in such exchange have the right to appear. After such hearing *the Commissioner may refuse a permit authorizing such exchange if in his opinion the plan is not fair, just, or equitable to all security holders affected.* (Emphasis added.)

As noted above, the legislative history of the statute interpreted "exchange," in the earlier version of section 25009, to mean what is now included under the heading of "any change" in the present section 25009. The construction which the California Administrators have put on the statute is such that although "any change" has now come into its own, as it were, in the definition of "sale," such "changes" still fall under the heading "exchange."¹⁰⁵ The reason for this is to make applicable section 25510, providing for this discretionary power in the Commissioner. The court in *Western Air Lines, Inc. v. Stephenson, Commissioner of Corporations*¹⁰⁶ said that the question of an "exchange" was not before respondent, notwithstanding his findings of fact and conclusions, and was not a part of its review.¹⁰⁷ A court, therefore, has not been able to review this problem of whether section 25510 applies to "changes in rights."

Section 26100 provides that "every security of its own issue sold or issued by any company without a permit . . . is void."¹⁰⁸

1. *The Western Air Lines Case.* Plaintiff, Western Air Lines, Inc., is a Delaware corporation qualified to do and doing business in the State of California. The principal offices of Western are in Los Angeles; the minute books and other corporate records are kept at that office. During the last several years it has been the practice

¹⁰⁵ See Brief for Appellants, pp. 29-48, *Western Air Lines, Inc. v. Sobieski*, Comm'r, 12 Cal. Rptr. 719 (Dist. Ct. App. 1961).

¹⁰⁶ Blue Sky L. Rep. ¶ 70,396 (Calif. Super. Ct., L.A. County, July 17, 1958).

¹⁰⁷ Id. at 65,798. The District Court did not examine the question either. *Western Air Lines, Inc. v. Sobieski*, Comm'r, supra note 105.

¹⁰⁸ The word "issue" has presented a number of definitional problems, and these problems stem largely from the period when the California statute regulated in terms of "issues" of securities. For example, § 26100 formerly read: "Every security issued by any company without a permit . . . is void." The term "issue" was defined by *Blythe v. Doheny*, 73 F.2d 799, 803 (9th Cir. 1934): "'to issue' as defined by the lexicographers, signifies to send out; to put in circulation. In a popular sense, a corporation engaged in organization is said to issue stock when it obtains subscriptions for it. . . ." citing *American Pig-Iron Storage Co. v. State Bd. of Assessors*, 56 N.J.L. 389, 394, 29 Atl. 160, 161 (1894). See also *Domestic & Foreign Pet. Co. v. Long*, 4 Cal. 2d 547, 51 P.2d 73 (1935); *Rhoades v. Townsend*, 139 Cal. App. 121, 33 P.2d 860 (1954); *Dahlquist*, supra note 104, at 345. These problems are no longer as pressing as they once were, inasmuch as the statute now regulates in terms of "sales."

For a comment on the "void-voidable" distinction see text supra at note 54. Oregon is the only other state which retains "void" terminology in its statute: Ore. Rev. Stat. § 59.250 (1955). California, however, is the only state which "voids" the "security" as opposed to the "sale," and this, too, raises constitutional issues discussed below. See *Loss & Cowett*, Blue Sky Law 137 (1958).

of Western to hold four regular quarterly meetings of the board of directors per annum, two in California and two outside. The corporation has two transfer agents, one in Los Angeles and one in New York, and the Los Angeles transfer agent keeps the stock records. Another set of the stock records is kept by the Corporation Trust Company in Delaware. According to figures compiled by Western for a representative month, January, 1957, more than fifty-five per cent of the passengers flown by the corporation travelled between points originating or terminating within the State of California, and approximately thirty-four per cent of all passengers flown by the corporation during said month travelled between points originating or terminating within California. More than three quarters of all property (other than flight equipment) owned by Western is situated within California and less than one quarter of such property is scattered throughout numerous other states; the principal facilities for maintenance and overhaul are at Los Angeles. Approximately one half of the amount paid by Western for rentals on leaseholds and landing leases is paid with respect to property situated within California, with the balance paid for property in other states. And approximately three fifths of its total wages and salaries are paid to employees in California with the remaining two fifths paid to employees in other states, all such payments being made from California. The main bank account of Western, from which bills are paid, is maintained in California, and at least twice as much money is maintained in California banks as in the banks of all other states combined. California residents are the holders of over thirty per cent of the outstanding stock.

Western's certificate of incorporation, as permitted by the law of Delaware,¹⁰⁹ contained an article providing for cumulative voting by stockholders in the election of its directors. Another article reserved the right to "amend, alter, change or repeal any provision" in the certificate in the manner prescribed by statute. All the certificates of stock issued by Western contained a provision to the effect that by the acceptance thereof the holder "assents to and agrees to be bound" by all of the provisions of the certificate and amendments thereto. The Delaware corporation law¹¹⁰ provides that any Delaware corporation may amend its certificate. Western's board of directors, in accordance with the applicable provisions of the Delaware statute, on July 12-13, 1956, adopted resolutions setting forth the amendment desired, which would delete cumulative voting from the charter. This

¹⁰⁹ Del. Code Ann. tit. 8, § 214 (1953).

¹¹⁰ Del. Code Ann. tit. 8, § 242 (1953).

meeting was held in Nevada. The directors authorized the president and secretary to call a special meeting of Western's stockholders on Sept. 12, 1956, to consider this amendment. On July 31, 1956, Western's secretary, in Los Angeles, mailed to all shareholders a notice of the special meeting together with a proxy statement and form of proxy. Pursuant to the regulations of the California commission, Western, when so advised by the commission, filed an application for a "negotiating permit."¹¹¹ This permit was issued, and by this permit the commission approved the use of such proxies as had, prior to the date of such application, been received and which were not thereafter revoked.¹¹² On October 10, 1956, the special stockholders' meeting was held in Los Angeles and the resolution to delete cumulative voting was passed by a majority of those shares voting, and of the total shares outstanding. The next day Western filed an application seeking a permit authorizing it to consummate a "change in the rights and privileges" on its outstanding stock by effecting an amendment to its certificate. This application was eventually denied,¹¹³ and Western commenced an action in the Superior Court of Los Angeles County seeking judicial review of the commission's actions and praying that a writ of mandate issue directing the commissioner either to grant the permit applied for or to dismiss the proceeding in which said permit was sought.¹¹⁴

¹¹¹ Cal. Administrative Code, tit. 10, §§ 759-62 (1956). The commissioner contended that the preliminary step of soliciting the shareholders to effect such a change in the rights or preferences required a "negotiating permit."

¹¹² The findings of both courts is at variance with the finding of the commission. The commission took the position that the issuance of the "negotiating permit" did not validate the proxies solicited prior thereto; this, of course, meant that the commission found that a majority did not vote for the repeal of cumulative voting while the court found that they did. Brief for Appellants, app. A, pp. 50, 66. *Western Air Lines, Inc. v. Sobieski*, Comm'r, supra note 105.

¹¹³ It may be useful at this stage to note why the commission denied the permit. Although the Delaware statute makes cumulative voting optional, it is mandatory for California corporations: Cal. Corp. Code § 2235. Thus California has a very strong interest in cumulative voting. On October 9, 1959, amendments were adopted to the California Administrative Code laying down the policy that applications for permits for the sale, by foreign corporations, of common stock without cumulative voting rights, or with limited or non-voting rights, will be considered by the commissioner "with disfavor": Cal. Administrative Code, tit. 10, §§ 367.1, 843, 844 (1959). Although it now looks as if the commission will be very hard on applications of corporations without cumulative voting, prior to this time, and at the time of the hearing in *Western Air Lines*, there was no express policy along these lines; in fact, it was quite possible for the application of a foreign corporation to be granted even though there was no cumulative voting: *Western States Petroleum Co., Inc.*, file no. LA-165414, Calif. Div. of Corps., Dec. 8, 1959. (The plan in this last-mentioned case was set up and the stockholders circularized prior to the publication of the above decision and amendments on cumulative voting; the commissioner, in the *Western States* case said that he did not "believe in retroactive rulings." *Id.* at 10.)

¹¹⁴ This summary of the facts is culled from the opinions of the courts in *Blue*

The commission's position is that the proposed amendment would constitute a "change in the rights, preferences, privileges, or restrictions on outstanding securities" of Western and, accordingly, would be a "sale" within the meaning of section 25009 of the Corporation Code, and that the solicitation of proxies in connection with the proposed amendment constituted a "sale" of securities within the meaning of that section. Thus, the resultant conclusion is that Western may not solicit proxies, or hold a stockholder meeting to pass on the amendment, nor should the amendment be filed in Delaware until the corporation has first applied for and obtained the requisite permits.¹¹⁵

The Superior Court believed that there was only one issue for determination, *i.e.*, whether the commissioner proceeded in excess of his jurisdiction. The court held that there was no violation of the blue sky law of that state: "no stock is to be 'sold,' nor has there been any solicitation to 'sell' in California."¹¹⁶ Furthermore, the court said that if the statute were to be interpreted to mean that Western had committed a violation, then the statute would be unconstitutional under the full faith and credit clause of the Constitution.¹¹⁷ The District Court reversed, holding that the commissioner had jurisdiction to act in this matter, "particularly where such corporation does a substantial amount of business within the State."¹¹⁸

2. *Extra-territoriality and Statutory Construction.* There is one very important rule which both courts adopt in this case: the acts which a blue sky law prohibit or regulate (*viz.* "sales" of securities, "changes in the rights" on securities, "attempts to" change the rights on securities)¹¹⁹ must be acts occurring *within the state*; or, at

Sky L. Rep. ¶ 70,396 (Calif. Super. Ct., L.A. County, July 17, 1958) and in 12 Cal. Rptr. 719 (Dist. Ct. App. 1961), and from "Findings of Fact and Conclusions" of the commission and "Amended and Corrected Findings of Fact and Conclusions of Law" of the Superior Court as reproduced in the Brief for Appellants, app. A, pp. 1-53, app. B, pp. 54-80.

¹¹⁵ The commissioner also would contend that the solicitation of proxies and the change of rights would fall under the heading of "attempt to . . . exchange" and "exchange"; see discussion *supra*.

¹¹⁶ Blue Sky L. Rep. ¶ 70,396, at 65,796.

¹¹⁷ *Ibid.*

¹¹⁸ 12 Cal. Rptr. at 727. The court remanded the case to the Superior Court with instructions to review the merits, that is, to see whether there was substantial evidence to support the commissioner's findings in denying Western's application.

¹¹⁹ Section 25009 provides that "sale" includes "an attempt to sell"; "sale" or "sell" includes "any change in the rights, preferences, privileges. . . ." The wording of the statute seems to be such that for the word, "sell," in "an attempt to sell," it is possible to substitute "change . . . the rights, preferences, privileges. . . ." This is the interpretation followed by the commission, for they contended that a solicitation of proxies is a "sale" within the meaning of the act. Blue Sky L. Rep. ¶ 70,396, at 65,794.

least to this extent a statute can have no extra-territorial effect.¹²⁰ This rule is acknowledged by the commissioner, for he attempts to argue, in the brief to the District Court that the "change in the rights," which would be effected by filing of the amendment in Delaware, will take place in California.¹²¹ On this principle, then, unless the "change in the rights" or the "attempt to" change the rights on the securities takes place in California, its blue sky law is inapplicable.¹²²

An "attempt to" change the rights on the outstanding securities, within the meaning of section 25009, *did* take place in California, in the form of proxy solicitation and a special stockholders' meeting. Leaving aside the question of constitutionality, the California statute does give the commissioner in this case jurisdiction to regulate acts which constituted an "attempt to sell (*viz.* change rights on)" a security.¹²³ To this extent the Superior Court is wrong in saying that no "solicitation to sell" took place in California within the meaning of section 25009.¹²⁴ What the Superior Court may be saying is that

¹²⁰ *McBreen v. Iceco*, 12 Ill. App. 2d 372, 377, 139 N.E.2d 848, 850 (1956) (It was held that a complaint under the Illinois securities act which failed to allege facts showing that the sale occurred in the state did not allege a cause of action: "There is no right of action under the statute unless the sale complained of took place in Illinois."); *Los Angeles Fisheries Inc. v. Crook*, 47 F.2d 1031 (9th Cir. 1931); *Brocalsa Chemical Co. v. Langsenkamp*, 32 F.2d 725 (6th Cir. 1929); *Robbins v. Pacific Eastern Corp.*, 8 Cal. 2d 241, 65 P.2d 42 (1937); *Mayer v. Rankin*, 91 Utah 193, 206, 63 P.2d 611, 617 (1936); *Estate of Suckow*, 192 Wis. 124, 212 N.W. 280 (1927). See also *Hall v. Geiger-Jones*, 242 U.S. 539, 557-58 (1917); *Gillis v. Pan American Western Pet. Co.*, 3 Cal. 2d 249, 254, 44 P.2d 311, 313-14 (1935); *People v. J. O. Beckman & Co.*, 347 Ill. 92, 97, 179 N.E. 435, 437 (1932); *Fletcher, Private Corporations* § 6742 (perm. ed. rev. 1954); *Dahlquist*, *supra* note 104, at 380. Therefore, as long as the prohibited acts occur within the state, the person committing same has violated the statute and is subject to its civil and criminal penalties: *People v. Sears*, 138 Cal. App. 2d 773, 791, 292 P.2d 663, 674 (1956) ("The Corporate Securities Act clearly prohibits a foreign corporation from soliciting in California a sale of stock of its own issue without first securing a permit, even though in good faith the issuance of the stock and transfer of title are to take place in a foreign state."); *People v. Rankin*, 169 Cal. App. 2d 150, 337 P.2d 182 (1959); *B. C. Turf & Country Club, Ltd. v. Daugherty*, 94 Cal. App. 2d 320, 210 P.2d 760 (1949); *People ex rel. Brundage v. Hill Top Metals Mining Co.*, 300 Ill. 564, 133 N.E. 303 (1921); *People v. Augustine*, 232 Mich. 29, 204 N.W. 747 (1925). See *State v. Swain*, 147 Ore. 207, 31 P.2d 745 (1934).

¹²¹ Brief for Appellants, at p. 93.

¹²² See note 120 *supra*.

¹²³ The existence of proxy solicitation in California gives the commissioner the power to enjoin such solicitation and hold up the plan until he passes on its fairness, for Regulation 780 (Cal. Administrative Code tit. 10, § 780 (1956)) says: "Such hearing may be held either in connection with the consideration of an application for a negotiating permit . . . or subsequent to issuance of such a permit and prior to the issuance of a definitive permit. . . ." Thus, the commissioner can hold hearings on the "negotiating permit," which is what the corporation applies for when it wants to get permission to solicit proxies; or, on the definitive permit.

¹²⁴ *Blue Sky L. Rep.* ¶ 70,396, at 65,796.

an interpretation of the statute which would treat these acts (proxy solicitation for, and a stockholders' meeting to vote on, the elimination of cumulative voting) as a "sale" within the meaning of the statute would be contrary to full faith and credit.

But there is a question as to whether the actual "change in the rights" on the securities took place in California. The Superior Court places the "situs" of the "change" in Delaware.¹²⁵ It is not clear whether the District Court agrees,¹²⁶ but that court is not troubled by this in view of its finding that the substantial amount of business performed by Western in California, and the acts which took place in California in furtherance of the scheme to eliminate cumulative voting, were sufficient to give the commissioner jurisdiction.¹²⁷

¹²⁵ It appears to this Court that, notwithstanding the prohibition in section 25009, of the Corporations Code, the exchange of petitioner's outstanding stock, if any, may, and any change in the "rights, preferences, privileges, or restrictions" as to such outstanding stock will certainly be, accomplished outside of the State of California by the means of the filing and recording of the Certificate of Amendment in the appropriate offices in Delaware. It is this Court's opinion that neither of such actions is within the permit requirements of the California "Corporate Securities Law"

Blue Sky L. Rep. ¶ 70,396, at 65,797.

¹²⁶ 12 Cal. Rptr. at 728. It is probably meaningless to talk about the "situs" of a "change in rights." The words "right" or "change in rights" are not words descriptive of actual things in the real world; rather, they are expressions which describe relations between persons. Hart, *Definition and Theory in Jurisprudence*, 70 L.Q. Rev. 37, 45 (1954). (Mr. Hart argues that the primary purpose of words such as "a legal right" is not to stand for or describe any *thing*, but to describe a distinct *function*. In order to define "a legal right" it is necessary to take a sentence in which the words appear and specify the conditions under which the whole sentence is true.) These relations do not have a "situs" anywhere; it is not meaningful to talk about an intangible such as the legal relation of a "change in rights" being situated somewhere in space. The view seems to be that the "situs" of an intangible is merely a legal conclusion to the problem of whether a state should, as a matter of policy, be able to regulate this legal relationship. Pomerance, *The "Situs" of Stock*, 17 Cornell L.Q. 43, 70-71 (1931): "The idea of a single fixed 'situs' of stock has proved a source of great confusion; results indicate that there is no such thing. 'Situs' is a term applied to a number of juristic results, which differ from one another quite properly, since they involve different considerations and are based upon varying policies. . . . What is important is that artificial theories of 'situs' should cease to rule and should be abandoned as misleading and more than useless, that control over stock always should be justifiable as a matter of policy and convenience." See also Note, 37 Minn. L. Rev. 285, 286 (1953); cf. Wood, *Reaching Shares of Stock*, 38 W. Va. L.Q. 219 (1952). On this view the question whether a "change in rights" took place in California is really: "Should California as a matter of policy be able to regulate this type of transaction?"

¹²⁷ 12 Cal. Rptr. at 727. The court also mentions, as further support to its finding of jurisdiction, the fact that Western's predecessor was a California corporation, and that the California commissioner granted Western a permit in 1929 to exchange its shares for all the outstanding shares of the California predecessor. At that time Western represented to the commissioner that the shareholders of the California corporation would "not be hurt" in any way by the exchange: "Thus it is apparent that the condition agreed to by Western as a basis for the original exchange of stock now

The rule, therefore, seems to be that when a foreign corporation, particularly one which does a "substantial" amount of business in California, having a "substantial" number of California stockholders, performs a "substantial" number of acts in California in furtherance of its intent to amend its charter so as to "change" in any way the rights of its shareholders, it is "selling" a security under the California blue sky law, despite the fact that the filing of the amendment takes place in another state, and it must prior to filing obtain a permit. It is plain to see that there are a host of uncertainties and ambiguities inherent in this rule.

3. *Constitutionality.* The next question is whether the California blue sky law, as construed by the District Court is unconstitutional on its face, or is unconstitutional in its application in any given case.

a. *The Internal Affairs Rule.* The basis of the Superior Court's determination of unconstitutionality seems to be that the transactions are "internal affairs" of a foreign corporation; or, that under the Constitution only Delaware can regulate these "internal affairs."

The classical "internal affairs" rule may be stated thus: a state has no visitorial powers over foreign corporations and ordinarily its courts will not interfere in their internal affairs and management.¹²⁸ This is a rule invoked when a court does not wish to exercise its jurisdiction over a particular action or suit. This rule also applies in the federal courts, but it seems to be part of the larger doctrine of "forum non conveniens."¹²⁹ The rule is particularly applied in cases which will involve the construction and interpretation of a statute of the state of the corporation's creation, or a broad question

tactly prevents the company from depriving its shareholders of a right which they would now have had if the 1929 exchange had not taken place." Ibid.

¹²⁸ *Kelly v. American Sugar Ref. Co.*, 139 F.2d 76 (1st Cir. 1943), cert. denied, 321 U.S. 791 (1944); *Hirshon v. Mine Safety Appliances Co.*, 54 F. Supp. 588 (W.D. Pa. 1944); *Ellis v. Mutual Life Ins. Co.*, 237 Ala. 492, 187 So. 434 (1939); *Sharp v. Big Jim Mines*, 39 Cal. App. 2d 435, 103 P.2d 430 (1940); *Miles v. Woodward*, 115 Cal. 308, 46 Pac. 1076 (1896), modified, 115 Cal. 308, 47 Pac. 360 (1897); *Graeser v. Phoenix Fin. Co.*, 218 Iowa 1112, 254 N.W. 859 (1934); *Pratt v. Mutual Life Ins. Co.*, 157 Kan. 710, 145 P.2d 113 (1944); *Kimball v. St. Louis & S.F. Ry.*, 157 Mass. 7, 31 N.E. 697 (1892); *Reed v. Woodmen of World*, 94 Mont. 374, 22 P.2d 819 (1933); *Allen v. Montana Ref. Co.*, 71 Mont. 105, 227 Pac. 582 (1924).

¹²⁹ *Koster v. Lumberman's Mut. Co.*, 330 U.S. 518 (1947); *Williams v. Green Bay & Western Ry.*, 326 U.S. 549 (1946); *Rogers v. Guaranty Trust Co.*, 288 U.S. 123 (1933). See Braucher, *The Inconvenient Federal Forum*, 60 Harv. L. Rev. 908 (1947); Notes, 46 Colum. L. Rev. 413 (1946), 42 Iowa L. Rev. 90 (1956); Comment, 56 Yale L. J. 1234 (1947). Some state courts also consider the rule as part of the doctrine of "forum non conveniens." *Kelly v. American Sugar Ref. Co.*, 139 F.2d 76 (1st Cir. 1943), cert. denied, 321 U.S. 791 (1944); *Lydia E. Pinkham Medicine Co. v. Gove*, 303 Mass. 1, 20 N.E.2d 482 (1939); *Royal China v. Regal China Corp.*, 304 N.Y. 309, 107 N.E.2d 461 (1952); *Goldstein v. Lightner*, 266 App. Div. 357, 42 N.Y.S.2d 338 (1943).

of that state's public policy;¹³⁰ and, in cases where proceedings are pending in the domiciliary state.¹³¹ It has been said that the rule is based on considerations of policy and propriety,¹³² or on the inability or want of power in the courts to enforce or effectuate their orders or decrees.¹³³ To this rule, which is only discretionary,¹³⁴ there are two exceptions: (1) it is generally held to be inapplicable where there are allegations of fraud or conscious wrongdoing;¹³⁵ (2) it is inapplicable to a corporation which is "foreign" in a technical sense only.¹³⁶

¹³⁰ *Kelly v. American Sugar Ref. Co.*, 139 F.2d 76 (1st Cir. 1943), cert. denied, 321 U.S. 791 (1944); *Mayer v. Oxidation Products Co.*, 110 N.J. Eq. 141, 159 Atl. 377 (1932).

¹³¹ *Healey v. R. J. Reynolds Tobacco Co.*, 48 F. Supp. 207 (M.D.N.C. 1942); *Wright v. Post*, 268 Mass. 126, 167 N.E. 278 (1929).

¹³² *Hirshon v. Mine Safety Appliances Co.*, 54 F. Supp. 588 (W.D. Pa. 1944); *Ellis v. Mutual Life Ins. Co.*, 237 Ala. 492, 187 So. 434 (1939); *State v. Iowa Southern Util. Co. of Delaware*, 231 Iowa 784, 2 N.W. 2d 372, supplemental opinion, 4 N.W.2d 869 (1942); *State ex rel. Weede v. Bechtel*, 239 Iowa 1298, 31 N.W.2d 853 (1948), cert. denied, 337 U.S. 918 (1949) (same case on the merits).

¹³³ *Rogers v. Guaranty Trust Co.*, 288 U.S. 123 (1933); *United Milk Prod. Corp. v. Lovell*, 75 F.2d 923 (6th Cir.), cert. denied, 295 U.S. 751 (1935); *Edwards v. Schillinger*, 245 Ill. 231, 91 N.E. 1048 (1910); *North State Copper & Gold Min. Co. v. Field*, 64 Md. 151, 20 Atl. 1039 (1885); *Allen v. Montana Refining Co.*, 71 Mont. 105, 227 Pac. 582 (1924); *Babcock v. Schuylkill & L. V. Ry.*, 56 Hun. 649, 9 N.Y. Supp. 845 (1890); *Corry v. Barre Granite & Quarry Co.*, 91 Vt. 413, 101 Atl. 38 (1917).

¹³⁴ *United Milk Prod. Corp. v. Lovell*, 75 F.2d 923 (6th Cir.), cert. denied, 295 U.S. 751 (1935); *American Creosote Works v. Powell*, 298 Fed. 417 (5th Cir.), cert. denied, 265 U.S. 595 (1924); *Mayer v. Oxidation Products Co.*, 110 N.J. Eq. 141, 159 Atl. 377 (1932); *Babcock v. Schuylkill & L. V. Ry.*, 56 Hun. 649, 9 N.Y. Supp. 845 (1890).

¹³⁵ *Lesnick v. Public Industrial Corp.*, 144 F.2d 868 (2d Cir. 1944); *Overfield v. Pennroad Corp.*, 133 F.2d 6 (3d Cir. 1940); *United Milk Products Corp. v. Lovell*, 75 F.2d 923 (6th Cir.), cert. denied, 295 U.S. 751 (1935); *American Creosote Works v. Powell*, 298 Fed. 417 (5th Cir.), cert. denied, 265 U.S. 595 (1924); *Hirshon v. Mine Safety Appliances Co.*, 54 F. Supp. 588 (W.D. Pa. 1944); *Edwards v. Schillinger*, 245 Ill. 231, 91 N.E. 1048 (1910); *Lydia E. Pinkham Medicine Co. v. Gove*, 303 Mass. 1, 20 N.E.2d 482 (1939); *Tarlow v. Archbell*, 47 N.Y.S.2d 3 (Sup. Ct. 1943); *Werner v. Becker*, 43 N.Y.S.2d 294, aff'd., 296 App. Div. 837, 70 N.E.2d 556, 56 N.Y.S.2d 363 (1945); *Goldstein v. Lightner*, 266 App. Div. 357, 42 N.Y.S.2d 338 (1943); *Ernst v. Rutherford & Boiling Springs Gas Co.*, 38 App. Div. 388, 56 N.Y. Supp. 403 (1899); *Kelly v. Thomas*, 234 Pa. 419, 83 Atl. 307 (1912). *Contra*, *Sternfeld v. Toxaway Tanning Co.*, 290 N.Y. 294, 49 N.E.2d 145 (1943). See *Coleman, Corporate Dividends and the Conflict of Laws*, 63 Harv. L. Rev. 433, 435 (1950). For a general discussion of the "internal affairs" rule see *Fletcher, Private Corporations* §§ 8425-45 (rev. perm. ed. 1933).

¹³⁶ *State v. Iowa So. Util. Co. of Delaware*, 231 Iowa 784, 2 N.W.2d 372, supplemental opinion, 4 N.W.2d 869 (1942); *State ex rel. Weede v. Bechtel*, 239 Iowa 1298, 31 N.W.2d 853 (1948), cert. denied, 337 U.S. 918 (1949) (same case on the merits); *United Milk Products Corp. v. Lovell*, 75 F.2d 923 (6th Cir.), cert. denied, 295 U.S. 751 (1935); *Harr v. Pioneer Mechanical Corp.*, 65 F.2d 332 (2d Cir. 1933); *Sharp v. Big Jim Mines*, 39 Cal. App. 2d 435, 103 P.2d 430 (1940); *Lydia E. Pinkham Medicine Co. v. Gove*, 303 Mass. 1, 20 N.E.2d 482 (1939); *Hayman v. Morris*, 36 N.Y.S.2d 756 (Sup. Ct. 1942); *Corry v. Barre Granite & Quarry Co.*, 91 Vt. 413, 101 Atl. 38 (1917).

The courts have used the rule in refusing to take jurisdiction where a plaintiff shareholder is seeking to compel a foreign corporation to pay a dividend,¹³⁷ or to enjoin the corporation from paying a dividend.¹³⁸ They have used it in refusing to take jurisdiction of suits to compel the issuance of shares of stock,¹³⁹ or to enjoin the issuance of stock.¹⁴⁰ And the rule has also been employed where the courts have refused to take jurisdiction of a shareholder's suit seeking to cancel or void shares of stock of a foreign corporation,¹⁴¹ or seeking to have the court grant voting power to the suitor—voting power being denied by the foreign certificate of incorporation,¹⁴² or praying that the court void a merger or reorganization of a foreign corporation.¹⁴³

Apart from the fact that the "internal affairs" rule is one which is considered to be on its way out,¹⁴⁴ it is concerned with judicial and not legislative jurisdiction. There are a number of reasons why a court declines jurisdiction (*viz.* lack of power in the forum to enforce its decrees, reluctance to construe a foreign statute or another state's public policy, proceedings pending in another state), but, this

¹³⁷ *Goldstein v. Lightner*, 266 App. Div. 357, 42 N.Y.S.2d 338 (1943); *Fox v. Allied Stores*, 252 App. Div. 675, 300 N.Y. Supp. 1254 (1937).

¹³⁸ *Hamilton v. United Laundries*, 111 N.J. Eq. 78, 161 Atl. 347 (1932).

¹³⁹ *Boyette v. Preston Motors Corp.*, 206 Ala. 240, 89 So. 746 (1921); *Kansas & R. R. Construction Co. v. Topeka, S. & W. Ry.*, 135 Mass. 34 (1883); cf. *Southern Sierras Power Co. v. Railroad Comm'n*, 205 Cal. 479, 271 Pac. 747 (1928). Contra, *Guilford v. Western Union Tel. Co.*, 59 Minn. 332, 61 N.W. 324 (1894); *Babcock v. Schuylkill & L. V. Ry.*, 56 Hun. 649, 9 N.Y. Supp. 845 (1890). See also *In re Fryeburg Water Co.*, 79 N.H. 123, 106 Atl. 225 (1919). (This was a case in which a Maine corporation sought to compel the New Hampshire public service commission to approve that portion of a stock dividend which was represented by its capital investment in New Hampshire; it was a request for the approval by the commission of an increase of its capital stock, which had been authorized by the State of Maine. Held: the public service commission had no power to approve this stock dividend.)

¹⁴⁰ *Rogers v. Guaranty Trust Co.*, 288 U.S. 123 (1933); *Kimball v. St. Louis & S.F. Ry.*, 157 Mass. 7, 31 N.E. 697 (1892). Contra, *Harr v. Pioneer Mechanical Corp.*, 63 F.2d 332 (2d Cir. 1933). (This would seem to be a case of a corporation foreign in a technical sense only.)

¹⁴¹ *Rogers v. Guaranty Trust Co.*, 288 U.S. 123 (1933); *Allen v. Montana Refining Co.*, 71 Mont. 105, 227 Pac. 582 (1924); *Sternfeld v. Toxaway Tanning Co.*, 290 N.Y. 294, 49 N.E.2d 145 (1943); cf. *Mau v. Montana Pacific Oil Co.*, 16 Del. Ch. 114, 141 Atl. 828 (1928). Contra, *American Creosote Works v. Powell*, 298 Fed. 417 (5th Cir. 1924), cert. denied, 265 U.S. 595 (1924) (This would seem to come under the fraud exception); *State v. Iowa So. Util. Co. of Delaware*, 231 Iowa 784, 2 N.W.2d 372, supplemental opinion, 4 N.W.2d 869 (1942); *State ex rel. Weede v. Bechtel*, 239 Iowa 1298, 31 N.W.2d 853 (1948), cert. denied, 337 U.S. 918 (1949) (same case on the merits).

¹⁴² *Allen v. Montana Refining Co.*, 71 Mont. 105, 227 Pac. 582 (1924).

¹⁴³ *Harris v. Weiss Eng'r Corp.*, 267 App. Div. 96, 44 N.Y.S.2d 643 (1943); *Meisse v. Seiberling Rubber Co.*, 264 App. Div. 373, 35 N.Y.S.2d 504 (1942).

¹⁴⁴ *Cheatham, Goodrich, Griswold & Reese, Cases And Materials On Conflict Of Laws* 225 (4th ed. 1957).

discretionary judicial doctrine is different from the present question of whether a state can constitutionally regulate certain conduct. The classical "internal affairs" rule is not relevant on this issue.

b. *The Case Law.* The cases of *Transportation Bldg. Co. v. Daugherty*,¹⁴⁵ *Commonwealth Acceptance Corp. v. Jordan*,¹⁴⁶ *Schroeter v. Bartlett Syndicate Bldg. Corp.*¹⁴⁷ and *Southern Sierras Power Co. v. Railroad Commission*,¹⁴⁸ cited by the Superior Court are of

¹⁴⁵ 74 Cal. App. 2d 604, 169 P.2d 470 (1946), hearing denied, Cal. Sup. Ct., July 18, 1946. In that case a California corporation had applied to the corporation commissioner for a permit to amend its articles, which amendment would bring about certain changes in the capital stock structure. At that time the California blue sky law directed the commissioner to grant a permit if he found "the proposed plan of business *not unfair, unjust or inequitable*." The commissioner denied the permit. The corporation sought a writ of mandate, and that writ was granted when the court found that the plan was not "unfair, unjust or inequitable." Apart from the fact that this case has been criticized because the superior court exercised its own judgment rather than the "substantial evidence" rule of *McDonough v. Goodsell*, 13 Cal. 2d 741, 91 P.2d 1035 (1939) (see Brief for Appellants, pp. 43-44), the case does not raise the problem of legislative jurisdiction over the "internal affairs" of a foreign corporation. See *Western Airlines v. Sobieski*, Comm'r, 12 Cal. Rptr. at 725.

¹⁴⁶ 198 Cal. 618, 246 Pac. 796 (1926). Petitioner brought an application for the issuance of a writ of mandate to require the secretary of state of California to receive and file in his office a duly certified copy of the petitioner's charter, together with certain other required documents and to accept the amount of the license fee. These had been tendered as a prerequisite to the qualification of petitioner to transact business in California. The application had been denied because the stock capitalization of the corporation was represented by shares of different par values; i.e., if that corporation had attempted to organize in California with a like stock structure, it would not have received a charter. Held: writ issued. The fact that a foreign corporation has been given powers which a domestic corporation does not possess does not mean that they may not be permitted to enter such other states and transact business therein under the doctrine of comity, "in the absence of *express constitutional or statutory inhibitions* on the part of those states which such foreign corporations thus seek to enter." (Emphasis added.) Id. at 624; 246 Pac. at 800. The last sentence merely states the issue being dealt with in the text: given certain express statutory inhibitions, can the foreign corporation still transact business free of these inhibitions?

¹⁴⁷ 8 Cal. 2d 12, 67 P.2d 824 (1936). The plaintiff, a shareholder in the defendant domestic corporation, recovered judgment for amounts paid by him on certain assessments on his stock. The court below found that the corporation had no authority to levy assessments. The controversy was over a change in the law. The law at the time the corporation was formed was to the effect that the board of directors could levy assessments. That law was changed to forbid assessments unless the articles so provided. Although prior to the levy in this case the articles did not allow assessments, the corporation argued on appeal that its right to assess must be measured by the way the law stood originally; to measure their rights by the later law would constitute an impairment of the obligations of contract. Held: judgment affirmed. The "reserved power" of the State of California gives the state the right to alter or amend its "contract" with its corporations, and pursuant to that right the state could alter the law on assessments without impairing any contract rights. Moreover, the new statute did not completely take away the right to assess; the right could now exist only under certain conditions. This case is not particularly helpful on the issue of legislative jurisdiction over foreign corporations.

¹⁴⁸ 205 Cal. 479, 271 Pac. 747 (1928). The petitioner sought a writ of mandate

very little help on this issue. There are some cases which seem to support the Superior Court's interpretation of the full faith and credit clause.¹⁴⁹ One such case is *Miles v. Woodward*.¹⁵⁰ There a shareholder of a California corporation brought an action against a director to recover damages for a violation of the provisions of a statute requiring the making, posting and filing of weekly reports, designed for the protection of shareholders. The defendant argued, *inter alia*, that the act was unconstitutional for the reason that it operated only on domestic corporations and thereby allowed foreign corporations to transact business within California on more favorable conditions than are prescribed by law for similar corporations organized under California law. The court held, as to this contention, that the statute did not discriminate in favor of foreign corporations, because California could not prescribe this kind of legislation for foreign corporations anyway:

to compel the railroad commission to issue its permit for the issuance of certain stock. The commissioner declined its permit on the ground that it had no jurisdiction over the issuance of stock by a foreign corporation. Held: the petition was denied. The opinion is confused, but the court seems to be saying that the Public Utilities Act of California regulating the issuance of stock, by its terms, does not apply to foreign corporations. See *Gillis v. Pan American Western Petroleum Co.*, 3 Cal. 2d 249, 252, 44 P.2d 311, 313 (1935); *Dahlquist*, *supra* note 104, at 380. See *Western Air Lines v. Sobieski*, Comm'r, 12 Cal. Rptr. at 725-26. However, the court in *Southern* makes some surprising statements. For instance, they say that, "While the term 'internal affairs' is more or less indefinite, there can be no question but that the issuance of stock by a corporation is purely an internal affair." 205 Cal. at 483, 271 Pac. at 748. Surely, the court cannot mean that a state has no power to regulate the sale or issuance of stock of a foreign corporation in California. See text *supra* at note 93. The court qualifies this broad statement by saying that "... to entertain an action to compel its issuance would clearly constitute the exercise of visitatorial powers over the corporation. . . ." 205 Cal. at 483, 271 Pac. at 748. However, this statement hardly seems to be relevant to the facts of *Southern*. All this lessens the effect of an earlier dictum: "While the legislature has the power to dictate under what terms and conditions foreign corporations may transact business in this state, this power does not extend so far as to give the legislature the power to regulate or control the 'intra vires' acts of such corporations concerning their internal affairs. Over such matters it has no control." *Id.* at 482, 271 Pac. at 748.

¹⁴⁹ In *re Fryeburg Water Co.*, *supra* note 139. The facts of that case are distinguishable from *Western Air Lines*, but one statement of the court's is worthy of mention: "If the amount of its capital stock is limited by the act of incorporation, the legislature of another state where it happens to be engaged in business, *has no power* to increase or diminish the amount of stock thus fixed and established . . . the petitioner's request for the approval by the commission of an increase of its capital stock, which has been authorized by the law of Maine, is misconceived, and is an *application for the exercise of power by the commission which it does not possess*." (Emphasis added.) 79 N.H. at 124, 106 Atl. at 227. This can be read to mean that New Hampshire is constitutionally inhibited from regulating or in any way tampering with, the capital stock figure of a foreign corporation. See *Western Air Lines v. Sobieski*, Comm'r, 12 Cal. Rptr. at 725.

¹⁵⁰ 115 Cal. 308, 46 Pac. 1076 (1896), modified, 115 Cal. 308, 47 Pac. 360 (1897).

The constitution was not designed to limit the powers of the legislature when dealing with the organization and government of corporations which are created by its own will and act. Over such corporations it has and may exercise full powers of control. Over the organization and internal government of foreign corporations it has no such powers. The laws of the state do not have extraterritorial force. It would be meaningless for this state to try to legislate upon the internal affairs of such foreign corporations, and it has not attempted to do so.¹⁵¹

The problem with this case is that it was decided in 1896, and at that time state judicial concepts of permissible regulation of foreign corporations were far more limited than what they are today. For example, under the present California blue sky law, which was originally adopted in 1917,¹⁵² a good deal of material has to be filed with the commission by foreign corporations before stock may be issued.¹⁵³ Thus, *Miles v. Woodward* does not lend much support to the Superior Court's view.

Other support may be found in the dicta of the oft-cited *Mau v. Montana Pacific Oil Co.*¹⁵⁴ In that case the jurisdiction of the Delaware Chancery court was invoked to determine the validity of the election of those directors of the Montana Pacific Oil Co., a Delaware corporation, who were declared to have been elected directors at a meeting held in Montana. The crucial point upon which the dispute turned was whether or not 389,265 shares of stock standing in the name of and voted by the defendant Montana Pacific Corporation, a Nevada corporation, were lawfully outstanding and therefore entitled to vote. The legality of those shares was questioned on the ground that they were issued by Montana Pacific Oil Co. in violation of the California blue sky law, and were, therefore, void. The court held that the stock was issued in Montana, and that the California blue sky law was inapplicable.¹⁵⁵ However, the court was prompted to say a few words about the "voiding" provision of the California statute:¹⁵⁶

It is rather difficult to see on what ground a state may rest a power to declare void stock issued by a foreign corporation in compliance with the law of its domicile. . . .

¹⁵¹ Id. at 311, 46 Pac. at 1077.

¹⁵² Cal. Stat. c. 532 at 673 (1917).

¹⁵³ Cal. Corp. Code §§ 25501-02; see also § 25515.

¹⁵⁴ 16 Del. Ch. 114, 141 Atl. 828 (1928).

¹⁵⁵ Id. at 120, 141 Atl. at 831.

¹⁵⁶ The present provision is in Cal. Corp. Code § 26100.

If one state has the power to enact laws declaring void as unlawfully issued the stock of a corporation of a sister state, lawfully issued under the law of the domicile, it is apparent that inextricable confusion is in danger of being introduced into the internal affairs of corporations. The membership in and the internal life of a state's corporate creature will be subject to as many conflicting masters as there are foreign jurisdictions. The logical result of such a doctrine is that one state has the power in effect, though not perhaps in form, to destroy the creatures of a sister sovereignty, for if it can nullify its stock for one reason it can for another. . . . Though the language of the section is general and in point of form applicable to all corporations, foreign as well as domestic, yet it is hardly to be doubted but that the courts of that State would, in construing the section, restrict the application of its general language to the field of its appropriate domestic application. It is undoubtedly within the power of a state to regulate the sale of securities, whether domestic or foreign, to the public and to inflict penalties upon all those who make such sales in violation of the statutes. It is doubtless likewise equally competent for the state enacting such laws to provide for the voiding of stock of its own creatures if sold in violation of its law. But no court has gone so far as to say that the legislative power can extend so far as to operate extra-territorially by way of declaring to be void the stock of a corporation created under the law of another sovereignty.¹⁵⁷

The California courts have expressly declined to follow this dictum.¹⁵⁸

¹⁵⁷ 16 Del. Ch. at 120-21, 141 Atl. at 831; cf. *Triplex Shoe Co. v. Rice & Hutchins*, 17 Del. Ch. 356, 363, 152 Atl. 342, 346 (1930); *Dunham v. Chemical Bank & Trust Co.*, 180 Okla. 537, 71 P.2d 468 (1937); *Coffield v. Ernsperger*, 187 Okla. 79, 101 P.2d 251 (1940); *Braniff v. Coffield*, 199 Okla. 604, 190 P.2d 815 (1947). Even though the stock is "voidable" at the behest of innocent purchasers (see text *supra* at note 54), the court, in such an action by an innocent purchaser still has the power under § 26100 to declare the stock "void."

¹⁵⁸ *Gillis v. Pan American Western Pet. Co.*, 3 Cal. 2d 249, 254-55, 44 P.2d 311, 314 (1935). The court, in *Gillis*, is itself often confused about whether it is talking about voiding the "security" or voiding the "issuance" of a security. At one point the court says, after distinguishing a series of cases (including *Mau*), that: ". . . they are not persuasive of the point that the state lacks the power to declare void the issuance of securities." (Emphasis added.) Id. at 313, 44 P.2d at 252. Moreover, none of the cases cited in *Gillis* lend any authority to the proposition that a state can declare void the "security" of a foreign corporation for failure to comply with its blue sky law. Id. at 253-54, 44 P.2d at 313-14.

The question in applying this case to the present issue is whether there is a difference between "voiding" foreign stock and regulating amendments to charters of foreign corporations. If one utilizes the so-called "governmental interest" test, generally adopted by the Supreme Court in interpreting the due process and full faith and credit clauses,¹⁵⁹ it is submitted that although California has an interest in protecting its residents from fraudulent stock schemes, its interest does not necessarily extend to "voiding" the stock; its residents are equally protected by simply "voiding" the sale. This unnecessary extension of its power only causes unreasonable and unjustifiable confusion. On the other hand, California has a very strong policy in favor of cumulative voting and in seeing that a foreign corporation, which does a substantial amount of business in the state, does not deprive its California shareholders (over thirty per cent of the total shares outstanding) of that chance of obtaining greater representation on the board. It is submitted that this is a sufficient "governmental interest" to sustain the constitutionality of the blue sky law as applied to Western Air Lines.

Lastly, there is the case of *Order of United Commercial Traveler's v. Wolfe*¹⁶⁰ which re-affirmed the proposition that the rights of membership in a fraternal beneficiary society are to be determined by the law of the state of incorporation. It is not questioned that the state attempting to regulate had a legitimate concern in seeking to protect its residents. In the scales of "weighing" the national and state interests, however, that concern lost out to the national need for uniformity of treatment of all the members of the beneficiary society. *Order of United Commercial Traveller's* is distinguishable,¹⁶¹ and represents the application of a constitutional test not followed in the great majority of Supreme Court cases and rejected by many leading commentators.¹⁶² The case is, at best, only weak authority in support of the Superior Court's position.

c. *Summary*. Applying what appears to be the current test for the due process and full faith and credit clauses, it is submitted that as applied to the *Western Air Lines* case, the California blue sky law is constitutional, and the District Court is correct, because

¹⁵⁹ See pp. 386-89 *supra*.

¹⁶⁰ 331 U.S. 586 (1947).

¹⁶¹ *Order of United Commercial Travellers* did not concern a business corporation organized for profit; membership in a fraternal beneficiary society is not like being a shareholder in a publicly held corporation and the Supreme Court has a special concern in the stability and solvency of these societies; it was a 5-4 decision. The District Court in *Western Air Lines* stated that the Supreme Court treats these cases of fraternal beneficiary societies as unique. 12 Cal. Rptr. 726.

¹⁶² See pp. 386-88 *supra* and notes 19-22, 24-25 *supra*.

California in this instance has a sufficient "governmental interest" in regulating: there is the strong California policy in favor of cumulative voting, more than thirty per cent of the shareholders resident in California, a substantial amount of business done by the corporation in California, proxy solicitation and a shareholders' meeting in California, and the past history of the corporation.¹⁶³

Another way of expressing the existence of a strong "governmental interest" in regulating the affairs of a foreign corporation is to call the company a "pseudo-foreign" corporation,¹⁶⁴ the concept of the "pseudo-foreign" corporation being an exception to the classical "internal affairs" rule.¹⁶⁵ An examination of the "pseudo-foreign" corporation cases, however, shows that this exception has only been applied where *all* or nearly *all* of the "foreign" corporation's property and membership were situated in the regulating state.¹⁶⁶

An example of such a case, and one used by the commissioner and the District Court, is *State v. Iowa Southern Utilities Co. of Delaware*,¹⁶⁷ which involved a Delaware corporation engaged solely in the operation of public utilities in Iowa where all of its property and assets were located. The board of directors of this corporation met in Chicago to propose an amendment to the charter whereby a reclassification of stock would be effected. By that reclassification, the outstanding shares were to be changed into new shares upon the filing of the amendment. The amendment was approved by a shareholders' meeting held in Iowa, and the amended certificate was filed in Delaware. Section 8412 of the Iowa Code of 1935 forbade domestic corporations from issuing par value stock at less than par; section 8413 forbade such corporations from issuing such stock for any consideration except cash without the permission of the executive council; section 8433 made those sections applicable to foreign utility corporations doing business in Iowa; and section 8437 declared shares issued in violation of these statutes to be "void." The plaintiff brought a statutory suit in equity in the name of the state of Iowa against the corporation to cancel the shares issued on the recent reclassification. The argument was forwarded that the new common stock which had been issued was issued without consideration and

¹⁶³ See note 127 *supra*.

¹⁶⁴ *Western Air Lines v. Sobieski*, Comm'r, 12 Cal. Rptr. at 727. See Latty, *Pseudo-Foreign Corporations*, 65 Yale L.J. 137 (1955).

¹⁶⁵ See note 136 *supra*.

¹⁶⁶ *Ibid*.

¹⁶⁷ 231 Iowa 784, 2 N.W.2d 372, supplemental opinion 4 N.W.2d 869 (1942); *State ex rel. Weede v. Bechtel*, 239 Iowa 1298, 31 N.W.2d 853 (1948), cert. denied, 337 U.S. 918 (1949) (same case on the merits). See *Western Air Lines v. Sobieski*, Comm'r, 12 Cal. Rptr. at 729.

without obtaining permission from the executive council. The court held, on defendant's motion to dismiss, that the Iowa statutes as applied to the defendant corporation did not deny it due process of law on the ground that such statutes would interfere with the "internal affairs" of a foreign corporation.¹⁶⁸

The first feature distinguishing that case from *Western Air Lines* is that the Iowa statutes were designed not only for the protection of shareholders, but primarily for the protection of creditors. It is a statute designed to forbid "watering" of stock. The state wants to make certain that at least the amount of par outstanding is in the till as a cushion for creditors. Thus, Iowa may have a stronger concern to regulate in that case than in the instance where a state is seeking to protect a class of persons who are already members of a corporation and who became members with the understanding that certain of their rights could be changed by charter amendment.

The second distinction is that the corporation in the Iowa case had much stronger connections with Iowa than Western has with California. All its property, save a bank account or two was in Iowa, all its books and records and nearly all the officers were in Iowa: "It was conceived in Iowa, born in Delaware, and has lived its entire life in Iowa."¹⁶⁹ This is not the case with Western Air Lines, which has only about three quarters of its property in California and a little more than thirty per cent of its shareholders resident in the state. Nevertheless, under the due process and full faith and credit clauses, as interpreted by the Supreme Court,¹⁷⁰ it is submitted that a state may constitutionally regulate a foreign corporation although it is not strictly a "pseudo-foreign" corporation under the old "internal affairs" rule. Thus, Mr. Latty in his article on "pseudo-foreign" corporations¹⁷¹ would treat a corporation as "pseudo-foreign" if its main business activity takes place in the domestic state, and if there is a "predominance of the local interests among those to be protected." He illustrates this by saying that, ". . . if most of the shareholders (or maybe even most of the *minority* shareholders outside the management group) are local residents, the local requirement for cumulative voting might be applied at the request of local shareholders."¹⁷²

Even if a "weighing of interests" test were applied there appears

¹⁶⁸ 231 Iowa at 827-28, 2 N.W.2d at 395.

¹⁶⁹ 231 Iowa at 807, 2 N.W.2d at 386.

¹⁷⁰ See pp. 386-89 *supra*.

¹⁷¹ Latty, *supra* note 164, at 161-63.

¹⁷² *Id.* at 161.

to be no compelling reason to disregard California's interest in this instance, which instance is succinctly stated by the District Court:

To hold otherwise, and to follow the argument of Western to its conclusion, would be to say that the commissioner might have the power in the first instance to require certain rights to be guaranteed to shareholders before he would permit the sale or issuance of a foreign corporation's stock in this State, but that immediately thereafter, by the device of amending the charter of such corporation in another state, the entire structure of that corporation, even to substantial changes in the rights of shareholders in California, might be legally effected. Such a holding would enable a foreign corporation to destroy the rights which the State of California has deemed worthy of protection by the enactment of the Corporate Securities Act.¹⁷³

4. *Problems.* The real problem facing the practitioner is in predicting how far the California commissioner of corporations will be able to go in extending the rule in *Western Air Lines*. What if the corporation does only twenty-five per cent of its business in California? What if it owns no property or has no bank accounts in California? What if only ten per cent or five per cent of the shareholders are California residents? What if there is no proxy solicitation or there are no meetings in California? Suppose the corporation wants to change its name; or does not want to amend its charter at all but merely wants to amend its by-laws to allow one director to constitute a quorum to fill vacancies on the board? Are these "changes in the rights, preferences and privileges" on the corporation stock? Is the statute unconstitutional if applied in any of these circumstances?

These are but a few of the problems which will arise under the rule in the *Western Air Lines* case. Take, for instance, the case of *Western States Petroleum Co.*¹⁷⁴ Corporation A is a Delaware corporation, with no property in California, and not qualified as a foreign corporation in California. Its principal and only place of business is Delaware. A has issued and outstanding 1,000 shares of stock, all owned by corporation B, also a Delaware corporation. None of the directors of A are residents of California. The incorporators met in Delaware to form A and all its directors' meetings have been

¹⁷³ *Western Air Lines v. Sobieski*, Comm'r, 12 Cal. Rptr. at 728.

¹⁷⁴ File No. LA-165414, Calif. Div. of Corps., Dec. 8, 1951. See Cowett, *Reorganizations, Consolidations, Mergers and Related Corporate Events Under the Blue Sky Laws*, 13 Bus. Law. 418, 760 (1958).

held in New York or Nevada. A made four agreements with four other corporations: (a) an agreement with corporation B by which B would exchange all of its assets for stock of A, and A would assume all the indebtedness of B; (b) a similar agreement with corporation C, a Delaware corporation, and a holding company which holds a controlling interest in corporation E. Its office is in Delaware; (c) a similar agreement with corporation D, a California corporation engaged in the production of crude oil and natural gas. The shareholders and properties of D are principally in California; (d) an agreement of merger by which corporation E will merge into A. E is a Delaware corporation with interests in two hundred and seventy-two oil wells and gas wells in over seven states, including California, and owning 71,837 undeveloped acres of land in ten states including California.¹⁷⁵ It seems that twenty per cent of the voting power of corporation E is owned by California residents. E's principal office is in Tulsa, Oklahoma, and at least three directors are California residents, although the meetings were being held in Nevada at the time of the merger agreements.

None of the meetings arranging the above agreements, and none of the board of directors meetings were held in California, nor were the agreements executed in California. There was no proxy solicitation in California. The shareholders' meetings called to approve the merger agreement were held in Delaware, and necessary approval was obtained there. If the steps of filing and recording the agreement of merger are taken, then the state of Delaware, by force of its law, converts the securities of each of the constituent corporations into the securities of the surviving corporation. There will be no issuance of the stock of the new company in California. The transfer of stocks pursuant to the exchange agreements (a)-(c) will take place outside California. If the entire plan is carried out, sixty-six per cent of the new preferred stock of corporation A and twenty-seven per cent of its new common stock will be in the hands of Californians. The California commissioner claims that these transactions are "exchanges" and "changes in the rights" within the meaning of section 25509 and that before such transactions can be consummated a permit must be obtained.¹⁷⁶

¹⁷⁵ The extent of E's property is not entirely clear. The commissioner found that E's property and shareholders were "principally" in California: File No. LA-165414, Calif. Div. of Corps., Dec. 8, 1951. Corporation A, in its application for a permit from the California commission claimed that E had no property in California: Application of Western States Petroleum Co., Inc., Commissioner of Corporations of the State of California, Nov. 4, 1959, pp. 5-6. The facts in the text are taken from Moody's Industrial Manual 2082 (1959).

¹⁷⁶ These facts were drawn from the following sources: Western States Petroleum

Very little treatment is given to the jurisdictional question in the commissioner's opinion. Unfortunately for the commentators (but fortunately for Western States) the petition was granted; therefore, the courts will not have an opportunity to explore the constitutional implications of this most complex factual situation.

The only way in which a "sale" could occur in California is if the "change in the rights" effected by the mergers occurred in California.¹⁷⁷ As noted above,¹⁷⁸ the question of the "situs" of a "change in rights" is really a question of whether California as a matter of policy believes it should regulate the transaction to protect its shareholders.¹⁷⁹ California believed it did have such an interest in approving the entire scheme in view of the large number of shareholders, resident in California, whose rights would be affected.

California has a very strong interest with respect to its own corporation (D); thus, as regards the sale of assets involving that corporation, there ought to be no constitutional difficulty. California also has an interest in seeing that its residents, having or about to have an interest in any of these foreign corporations, are not treated unfairly by the plan (*viz.* that dividend arrearages on preferred stock are not being eliminated unreasonably, that old common stockholders are not unreasonably wiped out, or that they receive some participation in the new company, whether shareholders in the new company may vote cumulatively). In view of these interests of the regulating state, there seems to be no great need for regulation by one law (*i.e.* et al. Delaware) in this case.

However, if a court were to sustain the constitutionality of this instance of regulation, it would be extending the rule of the *Western Air Lines* case to include regulation of transactions involving five corporations, where although a substantial number of California shareholders were involved, only two of the corporations actually

Co., Inc., File No. LA-165414, Calif. Div. of Corps., Dec. 8, 1959; Application of Western States Petroleum Co., Inc., Commissioner of Corporations of the State of California, Nov. 4, 1959; Moody's Industrials, section 1, at 1905 (1959); Moody's Industrial Manual 1000-1001, 2081-2082 (1959); Letter From John G. Sobieski, Comm'r, to the author, Jan. 4, 1960; Letters From F. Arnold Daum (director of one of the constituent corporations) to the author, Feb. 1, 1960 and Feb. 9, 1960.

¹⁷⁷ See note 120 *supra*. Since no physical act in furtherance of the proposed mergers occurred in California (as in the case of *Western Air Lines*), there could be no "exchange" of securities or no "attempt to change the rights on" the securities held by Californians.

¹⁷⁸ See note 126 *supra*.

¹⁷⁹ The one thing that seems clear is that there must be a California resident shareholder whose rights would be "changed" by the charter amendment or other corporate act.

did a substantial amount of business in California¹⁸⁰ (one of these being a domestic corporation), and no physical acts in furtherance of the scheme took place in California. We have not yet heard the last on the *Western Air Lines* case.

¹⁸⁰ There was a question as to the extent of corporation E's business in California. See note 175 *supra*.