CORPORATE LONG ARMS

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ABSTRACT

One of the most persistent debates among corporate law scholars has been whether the competition among states for corporate charters produces a race to the top or a race to the bottom. Some argue that the competition leads to the most efficient state emerging as the winner of the race. Others argue that the competition rewards the states that put the interests of managers—who have the power to choose the corporation's state of incorporation (the "home state")—ahead of the interests of shareholders and other stakeholders of the corporation. In this Article, I show how corporate long arm statutes could be used to facilitate a race to the top and mitigate the negative spillovers from a race to the bottom that may result from the competition for corporate charters. What I propose is that the rules of another state (a "host state") would become available to their intended beneficiaries when a host state has a greater interest than the home state in protecting such beneficiaries. I offer a few examples of how the proposed statute would work in practice and show that it is more cost-effective and politically feasible than other proposed alternatives.

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I. INTRODUCTION 1069

II. THE COMPETITION FOR CORPORATE CHARTERS 1074
A. Basic Parameters of the Race 1074
1. Race Awards: Fees and Taxes 1074
2. Race Awards: Corporate Law Setting Power 1076
3. Other Dimensions of the Race 1078
B. Debate About the Directions of the Race 1079
C. Competitive Pressures Arising from the Race 1081

III. CORPORATE LONG ARM STATUTES 1084
A. The Promise of the Corporate Long Arm Statute 1085
B. Where Existing Corporate Long Arm Statutes Fall Short 1087
C. Proposed Corporate Long Arm Statute and Its Application 1090
1. Removal of Directors by Court Proceedings (California v. Nevada) 1092
2. Shareholder Voting (California v. Delaware) 1093
3. Survival of Insider Trading Claims (California v. Delaware) 1095
4. Multilateral Competition 1097

IV. OBJECTIONS, COUNTERARGUMENTS, AND COMPARISON TO OTHER ALTERNATIVES 1097
A. Objections and Counterarguments 1098
1. Administrative Burden 1098
2. Constitutional Challenges 1099
3. Opt-In by States 1100
4. Private Ordering and the Freedom of Contract 1101
B. Comparison to Other Proposed Alternatives 1103
1. Federal Charter 1104
2. Regulating Foreign Qualifications and Reincorporations 1105
3. Reconsidering the Internal Affairs Doctrine 1106

V. CONCLUSION 1108

APPENDIX A: CAL. CORP. CODE § 2115 (THROUGH 2013 LEG. SESS.) 1108

APPENDIX B: N.Y. BUS. CORP. LAW §§ 1319–1320 (2015) 1111

I. INTRODUCTION

States collect a host of fees and taxes from the entities incorporated in their states. These include fees for filing, amending, correcting, and requesting certified copies of certificates and Uniform Commercial Code (UCC) financing statements, and for converting or dissolving the entity.[1] States also collect franchise taxes from companies organized in their state, which are typically based on the net worth, gross assets, or capital of the entity.[2] With nearly 5.9 million entities filing active corporate returns during the most recent tax year for which data is available, it is unsurprising that there is a competition among states to attract businesses and related fees and taxes to their states.[3]

In addition to fees and taxes, the internal affairs doctrine supplies another prize to the victor of the competition for corporate charters. The internal affairs doctrine provides that a single set of laws will govern the internal affairs of a corporation, and that that those laws will generally be the laws of the state of incorporation.[4] As a result, an entity's decision to incorporate in a state also gives that state the power to set the laws that govern the internal affairs of that corporation.[5] As more corporations incorporate in a particular state, that state becomes a major supplier of U.S. corporate law, which in turn strengthens that state's corporate bar and judiciary.

As is well known, Delaware has emerged as the winner in the competition for corporate charters in the United States. Nearly two-thirds of the Fortune 500 companies in 2016 (up from 58% in 2000) are incorporated in Delaware.[6] Many explanations have been offered as to why Delaware dominates this

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1. For an example of schedules of fees, see DEL. DIV. OF CORPS., FEE SCHEDULE (2016), https://corp.delaware.gov/Julyfee2016.pdf; *UCC Filing & Expedited Fees*, DEL. DIV. OF CORPS., https://corp.delaware.gov/uccfeesSept09.shtml (last visited Oct. 24, 2018).

2. For a survey of the corporate franchise tax in all fifty states and the District of Columbia, see CCH TAX LAW EDITORS, 2018 STATE TAX HANDBOOK (2017).

3. INTERNAL REVENUE SERV., 2013 STATISTICS OF INCOME: CORPORATION INCOME TAX RETURNS COMPLETE REPORT 1 (2013), https://www.irs.gov/pub/irs-soi/13coccr.pdf.

4. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 91 (1987) ("It . . . is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares."); Rogers v. Guar. Tr. Co., 288 U.S. 123, 130 (1933) ("[A] court . . . sitting in one State will as a general rule decline to interfere with . . . the management of the internal affairs of a [foreign] corporation . . . [and] will leave controversies as to such matters to the courts of the state of the domicile."). For a historical account of the doctrine's origins, see generally Fredrick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33 (2006).

5. While this Article focuses on corporations, the same dynamics apply to limited liability companies and other "unincorporated" associations.

6. DEL. DIV. OF CORPS., 2016 ANNUAL REPORT 1 (2016), https://corp.delaware.gov/2016AnnualReport.pdf ("66.4% of all Fortune 500 companies are incorporated in Delaware.").

race, which include its small size (which creates an outsized per capita incentive to maintain its dominance in this race),[7] its separate Court of Chancery (which acts without a jury and has developed expertise in corporate law matters),[8] and the responsiveness of the Delaware Legislature to corporate developments.[9] Professor Jill Fisch has suggested that Delaware's comparative advantage lies in the unusual role its courts play in lawmaking, which resembles legislation.[10]

While Delaware's dominance of the competition for corporate charters is indisputable, what is less clear, and vigorously debated, is whether Delaware's dominance is socially optimal.[11] On the one side, some have argued that Delaware has won the race for corporate charters because it offers an efficient and superior regime that other states have not been able to replicate (the "race to the top" view).[12] On the other side, some have argued that Delaware has won the race for corporate charters because it offers a

7. Delaware is a state with 961,939 residents (as of July 1, 2017), *Quick Facts: Delaware*, U.S. CENSUS BUREAU (2017), https://www.census.gov/quickfacts/DE, and more than one million business entities, STATE OF DEL., https://corp.delaware.gov/ (last visited Dec. 19, 2018) ("More than one million business entities take advantage of Delaware's complete package of incorporation services . . . .").

8. LEWIS S. BLACK, JR., WHY CORPORATIONS CHOOSE DELAWARE 5 (2007), https://corp.delaware.gov/whycorporations_web.pdf (describing the Delaware Court of Chancery's expertise in corporate law matters).

9. *Id.* at 1 (describing the Delaware legislature's role in keeping the corporation statute current).

10. Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1072–81 (2000).

11. This debate has been ongoing for at least forty years since Professor William Cary's seminal 1974 article that cautioned against a race to the bottom. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

12. *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 14–24 (1993) [hereinafter ROMANO, AMERICAN CORPORATE LAW]; Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 533 (2001) (finding that Delaware firms have higher shareholder value (by up to five percent)); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 915–23 (1982); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1909–10 (1998); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 841–49 (1995); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 279–80 (1985) (finding that firms that reincorporated in Delaware experienced statistically significant increases in stock prices); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 289–92 (1977) (arguing that competition amongst the states creates law that is market-driven and optimal for market and capital).

regime that is lax toward managers and other insiders who have control over the decision of where to incorporate (the "race to the bottom" view).[13]

In this Article, I take this debate as evidence that the competition for corporate charters has generated both positive and negative results. I acknowledge Delaware's preeminence in producing corporate law, but also heed the concerns that this primacy may at times advance the interests of incorporators at the expense of other stakeholders. In response to the latter concern, I argue that the judicious use of a corporate long arm statute as proposed in this Article can mitigate some of the negative spillovers from the competition for corporate charters.

The term "corporate long arm statute" is used throughout this Article to refer to a statutorily-created exception to the internal affairs doctrine. The long arm provision provides that a host state's[14] corporate laws shall extend to the internal affairs of foreign corporations if that host state's relationship with the corporation so justifies such extension.

While this concept is a significant departure from the internal affairs doctrine, it is not new. In fact, two of the most commercially significant states, California and New York,[15] have adopted some form of a long arm

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13. The "race to the bottom" describes a situation in which any state that passes regulations in the public interest faces the threat of revenue-generating companies leaving the state for a laxer jurisdiction. *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 204–06 n.18 (1933); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1509 (1992) [hereinafter Bebchuk, *Federalism and the Corporation*]; Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 389 (2003); Lucian Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775, 1784–89 (2002); Cary, *supra* note 11, at 685 (Cary's view is that Delaware seeks and maintains its advantage in the race for charter revenues by appeasing corporate managers); Stanley A. Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 435 (1968) ("Several states have succumbed to the revenue temptations inherent in the process of incorporating and offer charters to all comers on cheap terms with minimal internal restrictions. A race in the competitive laxity of corporation laws has succeeded in attracting to states such as Nevada or Delaware an inordinate proportion of the major corporations in the United States."); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 473 (1987); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1821, 1872 (2002).

14. Throughout this Article, the state of incorporation will be referred to as the "home state," and the state where a corporation does business as a foreign corporation will be referred to as the "host state."

15. In terms of gross domestic product (GDP), California's GDP exceeded $2.8 trillion, and New York's GDP exceeded $1.5 trillion as of May 4, 2018 (2017 Q4 data). *See* BUREAU OF ECON. ANALYSIS, U.S. DEP'T OF COMMERCE, GROSS DOMESTIC PRODUCT BY STATE: FIRST QUARTER 2018 tbl.3 (2018), http://www.bea.gov/system/files/2018-08/qgdpstate0718_2.pdf. California had the highest GDP among all U.S. states, accounting for nearly 14% of the total GDP of the

statute (sometimes referred to as an outreach statute) in their corporate codes.[16]

The California and New York corporate long arm statutes provide that specified provisions of the California Corporations Code (CACC) and New York Business Corporation Law (NYBCL), respectively, will apply to foreign corporations that do business in their respective states (as determined by specified objective criteria). The specified provisions fall squarely under the scope of internal affairs. They include the election, removal, and replacement of directors, directors' standard of care, limitations on corporate distributions, liability of directors and shareholders, and voting rules.[17]

Effective January 1, 2019, California's long arm statute was amended to add a new section 2115.5 to the CACC.[18] These amendments were made contemporaneously with the addition of CACC section 301.3 which requires a minimum number of women to sit on the board of directors.[19] CACC section 301.3 applies to not only California domestic corporations but also foreign corporations whose principal executive offices are located in California.[20]

United States. *Id.* New York had the third highest GDP among all U.S. states, with California and New York together accounting for nearly 22% of the GDP of the United States. *Id.* In terms of population, California accounts for approximately 12% of the U.S. population, and New York accounts for approximately 5.8% of the U.S. population. Of 11,463 active public companies in the Mergent-Intellect database, 1,875 (16.4% of total public companies in the U.S.) are located in California and 1,181 (10.2% of total public companies) are located in New York. *See* MERGENT-INTELLECT DATABASE (2018), http://www.mergentintellect.com/index.php/advancesearch/criteria/company (add filter "public private" and select "public" to obtain total active public companies, then add filter "California" or "New York" to obtain active public companies in each state). Of 47,063,908 active private companies in the Mergent-Intellect database, 5,535,513 (11.8% of total) are located in California and 2,597,292 (5.5% of total) are located in New York. *See id.* (add filter "public private" and select "private" to obtain total active private companies, then add filter "California" or "New York" to obtain active public companies in each state).

16. See *infra* Appendix A for full text of CAL. CORP. CODE § 2115 (West 2018), California's corporate long arm statute, and see Appendix B for full text of N.Y. BUS. CORP. LAW §§ 1319, 1320 (McKinney 2018), New York's corporate long arm statute. It should be noted that the corporate long arm provision is not a uniquely U.S. phenomenon. For example, Article 617 of the Korean Commercial Act provides that foreign companies headquartered in Korea or having the chief objective of carrying on its business in Korea must comply with the same rules that apply to a company incorporated in Korea. Sangbeob [Commercial Act], Act No. 1000, Jan. 20, 1962, *amended by* Act No. 10600, Apr. 14, 2011, art. 617 (S. Kor.), *translated in* Korea Legislation Institute online database, http://elaw.klri.re.kr/eng_service/main.do (login and search required). (I am grateful to Professor Kyung-Hoon Chun for this insight.)

17. *See infra* Appendix A and Appendix B.

18. CAL. CORP. CODE § 2115.5 (West 2018) (effective Jan. 1, 2019).

19. CAL. CORP. CODE § 301.3 (West 2018) (effective Jan. 1, 2019).

20. S.B. 826, 2018 Leg., Reg. Sess. (Cal. 2018) (section 2 adds §301.3(f)(2) to the Corporations Code). S.B. 826 is a follow up to Senate Concurrent Resolution (SCR) 62 (Res. Chap. 127, Stats. 2013) which urged corporations to diversify their corporate boards by December

While the potential reach of the New York and California long arm statutes is very extensive, they have not had much impact in practice due to their legal and design flaws. These flaws stem from the bluntness of these existing corporate long arm statutes, which makes them both under-inclusive in terms of their trigger and over-inclusive in terms of their reach (once triggered).[21] And for this reason, most of the literature and commentary on corporate long arm statutes have been focused on their limitations and argue for their repeal.[22]

This Article proposes a new design of the corporate long arm statute that can be used to address some of the persisting problems of mismatched incentives in the corporate law-setting environment. Part II describes the corporate law-setting environment and the mismatched incentives that are created by the internal affairs doctrine. Part III describes the potential for corporate long arm statutes to level the mismatch by taking into account host state interests in determining which laws and protections govern the internal affairs of corporations. I also make specific suggestions for a model design of the proposed corporate long arm statute and provide examples of its application in this Part. Part IV responds to some possible objections to the proposal. This Part also surveys other alternatives that have been suggested to prevent a race to the bottom or to facilitate a race to the top in corporate law and shows that the proposed corporate long arm statute faces fewer political constraints and is more cost-effective than these other alternatives. Part V concludes.

31, 2016, to increase the number of women on their boards from one to three. While California is the first U.S. state to mandate by law a minimum number of women on corporate boards, other countries have instituted legal quotas mandating a minimum percentage of board seats to be held by women directors. Anne L. Alstott, *Gender Quotas for Corporate Boards: Options for Legal Design in the United States*, 26 PACE INT'L L. REV. 38, 39 (2014).

21. *See infra* Section III.B.

22. *See* Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161, 179–82 (1985); John W. Edwards II, *Busy Bees and Busybodies: The Extraterritorial Reach of California Corporate Law*, 11 U.C. DAVIS BUS. L.J. 1, 58–65 (2010); Stephen R. Ginger, *Regulation of Quasi-Foreign Corporations in California: Reflections on Section 2115 After* Wilson v. Louisiana-Pacific Resources, Inc., 14 SW. U. L. REV. 665, 682–83 (1984); David M. Majchrzak, *Corporate Chaos: Who Should Govern Internal Affairs?*, 24 T. JEFFERSON L. REV. 83, 96–100 (2001). *But see* Andrew J. Collins, *Choice of Corporate Domicile: California or Delaware?*, 13 U.S.F. L. REV. 103, 104–08 (1978); John Hugh Newman, *The Pseudo-Foreign Corporation in California*, 28 HASTINGS L.J. 119, 121–26 (1976); Matt Stevens, *Internal Affairs Doctrine: California Versus Delaware in a Fight for the Right to Regulate Foreign Corporations*, 48 B.C. L. REV. 1047, 1051–61 (2007).

II. THE COMPETITION FOR CORPORATE CHARTERS

The competition among states for corporate charters has been one of the most widely written about topics in corporate law scholarship.[23] In particular, there has been a long standing debate about whether the competition has generated a race to the top or to the bottom.[24] Does relying on the individual states to charter and regulate corporations generate good or bad results for corporations and their stakeholders, and for our society?[25]

This Part will first describe the basic parameters of the competition for corporate charters—who are the relevant players and what is at stake? I will next synthesize the arguments on both sides of the debate about whether this competition is socially optimal or not. I then point to some of the competitive pressures that both sides of the debate seem to agree arise from this race. These pressures create mismatched incentives in the corporate law setting process, and these mismatched incentives are what the corporate long arm solution proposed here seeks to address.

A. Basic Parameters of the Race

1. Race Awards: Fees and Taxes

Nearly 5.9 million business entities filed active corporate returns in 2013, the most recent tax year for which data is available.[26] Each state collects a host of fees and taxes from the entities incorporated within its state.[27] These include fees for filing, amending, correcting, and requesting certified copies of certificates and UCC financing statements, and for converting or dissolving the corporation. States also collect franchise taxes from companies

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23. Symposium, *The Direction of Corporate Law: The Scholars' Perspective*, 25 DEL. J. CORP. L. 79, 88 (2000) (Jack Coffee referring to this debate as "the most overwritten theme in the academic literature about corporate law").

24. Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 590 (2003) ("One of corporate law's enduring issues has been whether state-to-state competitive pressures on Delaware make for a race to the top or to the bottom.").

25. This question received renewed attention with Senator Elizabeth Warren's recent introduction of a bill which would federalize some aspects of corporate law. On August 15, 2018, Senator Warren introduced the "Accountable Capitalism Act" which would, among other things, establish an Office of United States Corporations at the Department of Commerce to charter and regulate corporations with more than $1 billion in annual revenue. Accountable Capitalism Act, S. 3348, 115th Cong., 2d Sess. (2018); *see also* MARC I. STEINBERG, THE FEDERALIZATION OF CORPORATE GOVERNANCE 6–20 (2018).

26. INTERNAL REVENUE SERV., *supra* note 3.

27. *See generally* CCH TAX LAW EDITORS, *supra* note 2.

organized in their state, which are typically based on the net worth, gross assets, or capital of the business entity.[28]

Delaware has emerged as the dominant winner in the competition among U.S. states for corporate charters, continuing to increase its dominance by attracting nearly two-thirds of the Fortune 500 companies in 2016 (up from 58% in 2000).[29] General fund revenue collections by Delaware's Division of Corporations exceeded $1 billion for the first time in fiscal year 2015, which accounted for more than a quarter of the State of Delaware's general fund revenues for that same year.[30]

As a result, Delaware has become a state with more business entities than there are residents.[31] This outsized per capita effect of corporate chartering and franchise tax revenues motivates Delaware to continue to maintain its stronghold in the competition for corporate charters.[32] Additional explanations for Delaware's dominance include the significant influence that the local corporate bar, interest groups, and companies have on Delaware's legislature to maintain its primacy.[33] Much has also been written about the efficiency of Delaware's specialized judiciary, which acts without a jury,[34] and the unusual role its courts play in lawmaking, which resembles legislation.[35] The open question that remains is whether Delaware's stronghold is beneficial to all or only a subset of the stakeholders of the entities that choose to organize in Delaware.

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28. *See* Trent Dyker, *Delaware Franchise Tax: An Overview*, DLA PIPER, https://www.dlapiperaccelerate.com/knowledge/2018/delaware-franchise-tax-an-overview.html (last visited Dec. 19, 2018).

29. Kenju Watanabe, *Control Transaction Governance: Collective Action and Asymmetric Information Problems and Ex Post Policing*, 36 NW. J. INT'L L. & BUS. 45, 60 (2016); *see* DEL. DIV. OF CORPS., *supra* note 6.

30. *See* DEL. DIV. OF CORPS., *supra* note 6, at 1; *see also* DIV. OF ACCOUNTING, DEL. DEP'T OF FIN., 2015 DELAWARE COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 2015, at 21 (2015), https://auditor.delaware.gov/wp-content/uploads/sites/40/2017/01/State-of-Delaware-Fiscal-Year-2015-Comprehensive-Annual-Financial-Report-CAFR.pdf.

31. *See supra* note 7.

32. *BLACK*, *supra* note 8, at 1.

33. *Id.* at 4.

34. *See id.* at 5.

35. Fisch, *supra* note 10, at 1064, 1077–78.

2. Race Awards: Corporate Law Setting Power

In addition to fees and taxes, the internal affairs doctrine provides another reward for the victors in the competition for corporate charters.[36] The internal affairs doctrine provides that only one state's laws will govern the internal affairs of a corporation, and that one state is understood (although not without exceptions, as I explain further below) to be the state of the corporation's incorporation.[37] Simply put, Delaware's dominance in the competition for corporate charters results in Delaware General Corporation Law (DGCL) being widely regarded as U.S. corporate law.

The origin of the internal affairs doctrine can be traced back to early conceptions of the corporation in English Law, under which a corporation could be created only by a direct and specific royal grant.[38] Because of the special role that the chartering jurisdiction played in the creation of a corporation, it was generally accepted that the laws of the chartering jurisdiction would govern its internal affairs.[39] While a special charter from the legislature is no longer required to form a corporation—and indeed formation has devolved into a largely ministerial task[40]—the internal affairs doctrine has continued to receive broad acceptance.[41] The internal affairs doctrine has been described by Professor Deborah DeMott as a legal rule with

36. *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 91 (1987) (explaining that it is "an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.").

37. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (AM. LAW INST. 1971). Internal affairs are to be distinguished from the rights and liabilities of the corporation with third parties, which are to be governed by the laws which would control if the particular transaction involved an individual and not a corporation. *Id.* § 301. The internal affairs rule is also embodied in the Model Business Corporation Act (MBCA). *See* MODEL BUS. CORP. ACT §15.05(c) (AM. BAR ASS'N 2011) ("This Act does not authorize this state [the host state] to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state.") (amended 2016).

38. *See* Kaplan, *supra* note 13, at 439 ("In earlier times, when the word 'corporation' primarily denoted a legal entity created by direct and specific royal grant, there was not much question but that the governance of its internal affairs would be determined either by the charter itself or by the sovereign who granted it.").

39. *See id.* at 442 n.21 ("It follows that, strictly speaking, a corporation can have no legal existence beyond the boundaries of the State from which it receives its charter . . . .") (quoting WILLIAM L. MURFREE, LAW OF FOREIGN CORPORATIONS 2 (1893)).

40. *See, e.g.*, MODEL BUS. CORP. ACT § 1.20 (AM. BAR ASS'N 2011) (providing that so long as a document satisfies the requirements of this section, it shall be *entitled* to filing by the secretary of state).

41. State Farm Mut. Auto. Ins. Co. v. Superior Court, 8 Cal. Rptr. 3d 56, 64–68 (Ct. App. 2003).

an "irresistible intuitive appeal or force of logic," that provides uniformity, consistency, and predictability.[42]

One alternative to the internal affairs doctrine is the real seat doctrine that designates the location of the corporation's administrative headquarters as the corporation's state of domicile.[43] The real seat doctrine, much like the internal affairs doctrine, also looks to one state as the exclusive supplier of internal corporate rules. However, it differs from the internal affairs doctrine in that it looks to the location of the corporate headquarters, rather than the state of incorporation, as the supplier of such rules.[44] The real seat doctrine is derived from the understanding that the corporate headquarters is the beating heart of the corporation and thus its physical location should determine the jurisdiction that supplies the laws that govern the internal affairs of the corporation.

The corporate long arm proposal suggested here is a hybrid approach, best described as a form of interest analysis.[45] Interest analysis resolves substantive choice-of-law issues by balancing the interests of the applicable states and parties.[46] I argue that the corporate long arm proposal is the more reasoned approach in the modern era as both the choice of the state of incorporation and location of headquarters have become much less immutable decisions than they were at the time the internal affairs doctrine

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42. DeMott, *supra* note 22, at 161.

43. *See* Martin Gelter, Centros*, the Freedom of Establishment for Companies and the Court's Accidental Vision for Corporate Law*, *in* EU LAW STORIES: CONTEXTUAL AND CRITICAL HISTORIES OF EUROPEAN JURISPRUDENCE 309, 309 (Fernanda Nicola & Bill Davies eds., 2017); Werner F. Ebke, *The "Real Seat" Doctrine in the Conflict of Corporate Laws*, 36 INT'L LAW. 1015, 1015–16 (2002); Joseph A. McCahery & Erik P.M. Vermeulen, *Understanding Corporate Mobility in the EU: Towards the Foundations of a European 'Internal Affairs Doctrine*,*'* 3–4 (5th European Co. Law & Corp. Governance Conference, 2007), http://www.ecgi.org/presidency/presentations/2007_berlin_vermeulen_paper.pdf. The real seat doctrine is closely related to the "nerve center" test supported by the Supreme Court in *Hertz Corp. v. Friend*, 559 U.S. 77, 80 (2010) (looking to "the place where . . . high level officers direct, control, and coordinate the corporation's activities" as the principal place of its business). *See also* 28 U.S.C. § 1332(c)(1) (2018) ("[A] corporation shall be deemed to be a citizen of every State and foreign state by which it has been incorporated and of the State or foreign state where it has its principal place of business . . . ."). A review of the legislative history of section 1332(c)(1) shows that "principal place of business" was added to police manipulation. *Hertz*, 559 U.S. at 97. As a result, "principal place of business" is interpreted to mean much more than "a mail drop box, a bare office with a computer, or the location of an annual executive retreat." *Id.*

44. *See* Ebke, *supra* note 43, at 1016.

45. *See* BRAINERD CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS 189 (1963).

46. McCann v. Foster Wheeler LLC, 225 P.3d 516, 524 (Cal. 2010); Tucci v. Club Méditerranée, S.A., 107 Cal. Rptr. 2d 401, 407–08 (Ct. App. 2001).

and the real seat doctrine were first developed.[47] In addition, the corporate long arm proposal brings corporate law more in line with how other substantive areas of law address conflict of laws.[48]

3. Other Dimensions of the Race

While the internal affairs doctrine is one of the most basic understandings of U.S. corporate law, Professor Mark Roe highlights it is only that—"an understanding, not a crisp constitutional rule."[49] All corporate law could potentially be supplied from other sources, including federal law.[50]

In fact, Professor Robert Thompson describes the making of modern corporate law as a collaborative process between the federal government, state law, and the stock exchange.[51] Although some legal scholars have been critical of Sarbanes-Oxley[52] and Dodd-Frank[53] legislations' attempt to federalize corporate governance, federal law has long regulated important aspects of corporate governance. For example, federal disclosure rules and

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47. *Cf.* Amihai Glazer, L.A. TIMES, *L.A., Are You Sure You Want Amazon's HQ2?* (May 7, 2018, 4:15 AM), http://www.latimes.com/opinion/op-ed/la-oe-glazer-amazon-hq2-20180507-story.html (Amazon's recently announced search for the company's second headquarters and the resulting frenzy suggest there is a meaningful competition among cities for a corporation's administrative headquarters).

48. The internal affairs rule is difficult to square with the modern approach to resolving conflicts of laws. The Second Restatement of the Conflict of Laws instructs courts to apply the law of the state that has the most significant relationship to the parties, dispute, and issues at stake. William L. Reynolds & William M. Richman, *Multi-Jurisdiction Practice and the Conflict of Laws*, AM. BAR ASS'N (Oct. 5, 2011), https://www.americanbar.org/groups/professional_responsibility/committees_commissions/commission_on_multijurisditional_practice/mjp_wreynolds.html. This instruction represents a migration away from the traditional approach that was more static and territorial toward a more adaptable approach that relies less on rules and more an assessment of the relationship that each state has with the particular case and examining the policies behind each state's substantive rule. *Id*; *see also* Timothy P. Glynn, *Communities and Their Corporations: Towards a Stakeholder Conception of the Production of Corporate Law*, 58 CASE W. RES. L. REV. 1067, 1070 (2008) ("As is the case in other areas of regulation, the communities within which firm activities have substantial effects should be the ones to make and enforce corporate legal norms.").

49. Roe, *supra* note 24, at 597.

50. *See id.* at 598–600 (Roe defines federal government to include Congress, SEC, courts and stock exchanges); *see also* Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793, 1816–22 (2006).

51. Robert B. Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 WAKE FOREST L. REV. 961, 961–63 (2003).

52. *See, e.g.*, Roberta Romano, *Quack Corporate Governance*, REGULATION, Winter 2005–2006, at 36, 36–44.

53. *See, e.g.*, Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1796–1819 (2011).

proxy regulations under the Securities Act of 1933 and the Securities Exchange Act of 1934 govern the internal affairs of corporations, including shareholder voting.[54]

And on this basis, Professor Roe reconceptualizes the competition for corporate charters as one not among the fifty states but between Delaware and the federal government.[55] Professor Chris Brummer takes it a step further by characterizing the competition for corporate charters as one among nations.[56] These broader views of the competition for corporate charters are supported by increased corporate mobility and the rise of corporate tax havens such as Cayman Islands, Netherlands, and Bermuda, to name a few.[57]

These changes and developments in the corporate chartering environment suggest that now is an opportune time to reconsider the internal affair doctrine's reliance on the state of incorporation as the exclusive supplier of corporate law.

B. Debate About the Directions of the Race

One of the enduring debates in corporate law scholarship has been whether the competition for corporate charters is a race to the top,[58] or a race to the bottom,[59] or is not a race after all.[60] Professor William Cary first raised

54. Arthur Fleischer, Jr., *"Federal Corporation Law": An Assessment*, 78 HARV. L. REV. 1146, 1159 (1965).

55. Roe, *supra* note 24, at 593 ("The mechanisms that would make for a pure race are absent in a true federal system such as ours.").

56. Chris Brummer, *Corporate Law Preemption in an Age of Global Capital Markets*, 81 S. CAL. L. REV. 1067, 1092–93 (2008).

57. A large number of California long arm statute cases involve corporations incorporated in non-U.S. jurisdictions (including Bermuda and the Virgin Islands). *See, e.g.*, Saratoga Advantage Tr. Tech. & Commc'ns Portfolio v. Marvell Tech. Grp., Ltd., No. 15-CV-04881-RMW, 2016 WL 4364593 (N.D. Cal. Aug. 16, 2016); Voss v. Sutardja, No. 14-CV-01581-LHK, 2015 WL 349444 (N.D. Cal. Jan. 26, 2015); Vaughn v. LJ Int'l, Inc., 94 Cal. Rptr. 3d 166 (Ct. App. 2009). For a primer on corporate inversions, see also CONGRESSIONAL BUDGET OFFICE, AN ANALYSIS OF CORPORATE INVERSIONS 1 (2017), https://www.cbo.gov/system/files?file=115th-congress-2017-2018/reports/53093-inversions.pdf ("A corporate inversion occurs when a U.S. multinational corporation completes a merger that results in its being treated as a foreign corporation . . . even though the shareholders of the original U.S. company retain more than 50 percent of the new combined company.").

58. *See supra* note 12.

59. *See supra* note 13.

60. Robert B. Ahdieh, *Trapped in a Metaphor: The Limited Implications of Federalism for Corporate Governance*, 77 GEO. WASH. L. REV. 255, 305 (2009) (the decision of where to incorporate is better understood through the complexities of state and managerial competition for different pieces of law); Michal Barzuza, *Price Considerations in the Market for Corporate Law*, 26 CARDOZO L. REV. 127, 213–14 (2004) (arguing that the competition for corporate charters is

concerns about a race to the bottom in his 1974 article, and arguments in support of and against Cary's concerns have carried on ever since.[61]

One of the most widely cited studies in support of Professor Cary's view is Professor Lucian Bebchuk's account of the competition for corporate charters as one which rewards lax approaches to managerial self-dealing.[62] In another work, Professors Bebchuk, Alma Cohen, and Allen Ferrell present empirical evidence that state competition does not lead to an increase in firm share value, does not benefit shareholders, and does not induce states to adopt more moderate takeover regimes.[63] Professor Guhan Subramanian's empirical study also demonstrates that the states that have fared well in the competition for charters tend to be states with more anti-takeover and pro-manager rules.[64]

On the other hand, a number of studies provide empirical support for "race to the top" accounts of the competition for corporate charters.[65] Professors Ofer Eldar and Lorenzo Magnolfi's recent account of firms' choices of where to incorporate suggests that Delaware would lose its market share and revenues from incorporations if it were to adopt manager-friendly provisions.[66] Professor Roberta Romano's event study shows that corporations reincorporating in Delaware experience statistically significant positive abnormal returns.[67] Professor Robert Daines also presents empirical evidence to show that companies incorporated in Delaware produce superior returns.[68] In sum, both the theoretical and empirical data on the direction of the race are mixed.

The state of Nevada adds an interesting dimension to the race debate. In 2001, the Nevada Legislature revised Nevada's corporate code to offer both

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the sale and purchase of corporate charter revenue in exchange for favorable corporate law); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 748 (2002) (not a race, but Delaware's monopoly); Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1329 (2013) (arguing that there is not a race, either to the top or to the bottom, because Delaware has become the default option for newly public companies).

61. Cary, *supra* note 11, at 666.

62. Bebchuk, *Federalism and the Corporation*, *supra* note 13, at 1509.

63. Bebchuk, Cohen & Ferrell, *supra* note 13, at 1780–83.

64. Subramanian, *supra* note 13, at 1801.

65. *See supra* note 12.

66. Ofer Eldar & Lorenzo Magnolfi, *Regulatory Competition and the Market for Corporate Law* 24 (Yale Law & Econ., Research Paper No. 528, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2685969.

67. *See* ROMANO, AMERICAN CORPORATE LAW, *supra* note 12, at 14–24 (emphasizing that federalism, or competition amongst the states, is what drives innovation and positive results in corporate law).

68. Daines, *supra* note 12, at 533.

directors and officers greater protection from liability for breaches of their fiduciary duties.[69] Professor Michal Barzuza's work, which traces out-of-state incorporations in Nevada, shows that Nevada's strategy of adopting laws that are lax toward managers to attract more corporations to its state has been partially successful.[70] The Nevada experience offers support to the argument that the competition for corporate charters will drive some states to adopt lax laws to appease corporate managers. At the same time, the fact that Delaware maintains its dominance over Nevada, notwithstanding Delaware's stricter liability rules, offers support to the argument that there are more facets to the race than one toward laxity.[71]

In this Article, I take this debate about whether the competition for corporate charters is optimal for firms and their stakeholders as evidence that the competition for corporate charters produces both positive and negative outcomes. In the next subpart, I identify some of the problems and pressures created by the competition on which both sides of the debate seem to agree. This sets up the basic problem that the corporate long arm statute I propose in this Article attempts to address.

C. Competitive Pressures Arising from the Race

Both sides of the race debate agree that the competition for corporate charters has generated a unique set of pressures and parameters in the setting of U.S. corporate law. Delaware's (and Nevada's) strong performance, together with the internal affairs doctrine, creates a situation where the states that set much of U.S. corporate law are not the states where most stakeholders of these corporations reside nor the states where most of these corporations' business affairs are conducted.[72] As a result, the internal affairs doctrine has

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69. NEV. REV. STAT. § 78.138(7) (2018).

70. Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 977–78 (2012).

71. Delaware corporations may include a provision in their charter that limits the personal liability of directors (but not officers) for breaches of the duty of care, but not for breaches of the duty of loyalty or for acts or omissions not in good faith or which involve intentional misconduct, or for any transaction from which the director derives an improper personal benefit. DEL. CODE ANN. tit. 8, § 102(b)(7) (2018).

72. Roe, *supra* note 24, at 594 (noting that the average citizen in Delaware is primarily interested in keeping the revenues of corporate chartering but not necessarily in what the rules that provide those revenues actually are). Others have pointed to Delaware's disinterest as one of its strengths. *Cf.* Henry Hansmann, *Corporation and Contract* 13 (European Corp. Governance Inst. Working Paper Series in Law, Working Paper No. 66, 2006), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=892830 (pointing to the fact that Delaware

created an inevitable mismatch between where corporate law is made and where most of the beneficiaries of such laws are located.[73] While this mismatch is not inherently a problem, it reflects a departure from the traditional approach to resolving conflicts of laws which is to apply the law of the state that has *the most significant relationship* to the parties, dispute, and issues at stake. Furthermore, as explained above in subpart A.1., the corporate long arm proposal is the more reasoned approach in the modern era as the choice of the state of incorporation has become a much less immutable decision than at the time the internal affairs doctrine was first developed.

To highlight this mismatch, I use the example of one of the country's largest insurers, Farmers Group, Inc. ("Farmers"), a private corporation incorporated in Nevada.[74] While the state of Nevada has a stake in enacting

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"contains very few of the shareholders or companies whose affairs it regulates" as a reason for why it is a suitable and disinterested maker of corporate law).

73. Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 LAW & CONTEMP. PROBS. 135, 137–38 (2004).

74. *See* Andrew Verstein, *Enterprise Without Entities*, 116 MICH. L. REV. 247, 250, 270 (2017); *Company Overview of Farmers Group, Inc.*, BLOOMBERG (June 17, 2018), http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=956063. I intentionally chose the example of a Nevada company that does business in California to illustrate the dynamics of the competition among states for corporate charters. A recently published study shows that Nevada has been a significant competitor to California in the race for corporate businesses. *See* JOSEPH VRANICH, CALIFORNIA BUSINESS DEPARTURES: AN EIGHT-YEAR REVIEW 2008–2015 1–3 (2016). Vranich uses the term "disinvestment event" to refer to each instance where a business either moved out of California entirely or built a location in another state that could have been built in California. *Id.* at 1.

State	**California Disinvestment Events (Business Departures) to State 2008-2015**
Texas	247
Nevada	***100***
Arizona	73
Colorado	52
Washington	47
Oregon	44

Id. at 33 (emphasis added).

I chose Nevada (rather than Texas which is California's greatest competitor according to the Vranich data) as it is a jurisdiction that is known to compete on the laxity of its laws. *See* Barzuza, *supra* note 70, at 949. Barzuza reports the below data on the proportion of out-of-state incorporations in Nevada:

corporate laws to induce Farmers to remain a Nevada corporation, it does not otherwise have much of a stake in what these corporate rules actually are.[75] Meanwhile, California—the state where Farmers opened its first office and where it is headquartered[76]—has a greater stake than Nevada in the content of the rules which govern Farmers' internal affairs.[77] Yet, the internal affairs doctrine provides that the laws of Nevada, Farmers' state of incorporation, and not the laws of any other states in which Farmers does business or where Farmers stakeholders are located, will govern its internal affairs.

Imagine the extreme case, where Farmers does all of its business in California and all of its investors, lenders, consumers, suppliers, and other stakeholders are citizens of the state of California. The internal affairs doctrine provides that even in this case, Nevada, the state of incorporation, will supply the laws that govern the internal affairs of Farmers. In this extreme case, however, the pseudo-foreign corporation exception to the internal affairs doctrine offers some relief.[78] This exception provides that if a corporation is chartered in one place but does *all* of its activities and business in another place (the host state), then the host state's laws will apply to the

Year	**Proportion of Out-of-State Incorporations in Nevada**
2000	5.56%
2001	5.98%
2002	6.54%
2003	7.01%
2004	6.72%
2005	6.71%
2006	6.73%
2007	6.87%
2008	6.66%

Id.

75. Unless of course they are also an employee, customer, investor, or other stakeholder in Farmers that is impacted by its internal affairs, in which case they have a stake in what the Nevada rules as they apply to the corporation actually are.

76. Farmers has a total of forty-five locations in California. Farmers has four locations in Nevada, with 173 employees total at such locations. *Farmers Group, Inc.*, VAULT, http://access.vault.com/company-profiles/insurance/farmers-group,-inc/company-overview.aspx (login required).

77. The data suggests that this is a very likely scenario. Professors Eldar and Magnolfi report that California had only a 1.602% share for incorporations in 2013 for all firms in their sample while Nevada experienced a jump in its share for incorporations from 2.29% in 1995 to 10.43% in 2013. *See* Eldar & Magnolfi, *supra* note 66, at 10, tbl.1A.

78. Pseudo-corporations are enterprises whose existence, other than the fact of incorporation in another state, is limited to that state. *See* Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137, 144–45 (1955) (arguing that pseudo-foreign corporations should be governed by the laws of the host state).

internal affairs of the corporation.[79] This makes logical sense, and the result is consistent with the internal affairs doctrine's underlying goal of unifying the source of corporate law, as even in this exceptional case, there is a single body of law that applies. The difference is that for pseudo-foreign corporations, the single law comes from the host—not the home—state.

However, the pseudo-foreign corporation exception does not go far enough. One can avoid the exception by attracting just one stakeholder from outside of the host state to avoid the application of that host state's laws.[80] And as soon as multiple host states come into play, the exception is no longer available and the internal affairs doctrine applies.[81]

One of the attractive features of the internal affairs doctrine (and the pseudo-foreign corporation exception) is this guarantee that a single body of law applies to the internal affairs of a corporation. This uniformity helps facilitate corporate planning and is taken as a given in corporate law.[82] However, if this uniformity is achieved on an uneven playing field or it stands in the way of implementing future improvements to corporate law, is the resulting uniformity defensible? In the next Part, I offer the corporate long arm statute as a potential leveling mechanism for the corporate law setting field.

III. CORPORATE LONG ARM STATUTES

Corporate long arm statutes directly contradict the internal affairs doctrine by applying host state rules to internal affairs in the special cases where the contact that a corporation has with the host state justifies this application. While this may appear to be a radical departure from the well-established internal affairs doctrine, a number of states and countries have had, for many decades, a long arm provision in their corporate codes. As described further below, these provisions generally accept the internal affairs doctrine, but specify the exceptional cases where their states' corporate laws would apply even to the internal affairs of foreign corporations.[83] These long arm statutes

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79. *See id.*

80. *See* P. John Kozyris, *Some Observations on State Regulation of Multistate Takeovers—Controlling Choice of Law through the Commerce Clause*, 14 DEL. J. CORP. L. 499, 519 (1989); Latty, *supra* note 78, at 161.

81. Kaplan, *supra* note 13, at 438–39.

82. *Id.* at 464 ("The umbilical tie of the foreign corporation to the state of its charter is usually still religiously regarded as conclusive in determining the law to be applied in intra-corporate disputes.").

83. *See, e.g.*, Batchelder v. Kawamoto, 147 F.3d 915, 920 (9th Cir. 1998); Davis & Cox v. Summa Corp., 751 F.2d 1507, 1527 (9th Cir. 1985); *In re* Verisign, Inc., Derivative Litig., 531 F. Supp. 2d 1173, 1214–15 (N.D. Cal. 2007).

represent a compromise position between each state's general police power over business activity within its state and the centrality and convenience of the internal affairs doctrine. Unfortunately, several flaws in their design have prevented these long arm statutes from doing much work thus far.

The main claim of this Article is that corporate long arm statutes, if properly implemented, can offer a partial solution to the pressures and problems that are created by the competition for corporate charters and facilitate a race to the top in the competition for corporate charters. This Part scrutinizes currently available corporate long arm statutes, demonstrates the promise of the corporate long arm statutes, and makes suggestions and provides examples of a model design and implementation of a corporate long arm statute which would allow its full promise to be realized.

A. The Promise of the Corporate Long Arm Statute

The internal affairs doctrine provides the benefits of certainty, uniformity, and predictability. However, these benefits are not costless.[84] The main critique of the internal affairs doctrine has been that it dampens the efforts of any one well-intentioned state to introduce protective features in its substantive corporate law.[85] If, for example, a state amends its corporate statute to increase scrutiny of self-interested managerial conduct, managers could avoid such regulations by simply reincorporating to another state. The ease of reincorporation, together with the internal affairs doctrine's position that the rules of the state of reincorporation will apply to all internal affairs, will stand in the way of the newly introduced laws from doing their intended work.

The corporate long arm statute proposed in this Article mitigates this potential pernicious effect of the internal affairs doctrine by extending the protective features of such state's corporate laws to their intended beneficiaries when there are sufficient host state interests at play. For example, if 85% of the shareholders of a corporation reside in the state of California, a provision of the CACC that is intended to protect those shareholders could potentially apply to this corporation. This rule would only be presumptive in that it could be rebutted by showing that the disruptive

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84. Kaplan, *supra* note 13, at 440 ("Though this method had the disadvantage of artificiality, it had the presumably greater merit of simplicity and unity.").

85. E.R. Latty, *Some General Observations on the New Business Corporation Law of New York*, 115 BUFF. L. REV. 591, 609–10 (1962) ("A great barrier to the inclusion of strong protective features in any state corporation law long has been the utter futility of such features in face of the ease of evasion by simply incorporating in a state free from controls . . . .").

effect of extending the corporate long arm in that particular situation exceeds its prospective benefit. In the proposed regime, it would be the requesting stakeholder that would have the burden of justifying the displacement of the internal affairs doctrine.[86]

I argue that the corporate long arm statute can be an effective counterforce to the pro-managerial biases that may result from the race among states to attract managers to incorporate in its state. By operation of the corporate long arm statute, the power to prescribe laws which govern the internal affairs of corporations will no longer be exclusively held by the home state. This shift in the dynamics of the race will incentivize other states to become more invested in the race. This work is done by bringing host states with sufficient interests into the corporate lawmaking process to serve as a built-in floor to avoid a race to the bottom and to raise the ceiling in the setting of corporate law.

There are a number of areas like privacy, environmental, and insurance regulation where California and New York have stepped up to fill gaps.[87] Here, I show how corporate law is another area where those states can have an impact through the proper extension of their corporate long arm statutes. The recently enacted California law requiring public corporations chartered or headquartered in California to diversify their boards is one step in this direction.[88]

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86. In *Edgar v. MITE Corp*, the Supreme Court held that a state has no interest in regulating the internal affairs of foreign corporations, and it was the burden of the state to justify any displacement of the internal affairs doctrine. 457 U.S. 624, 645 (1982).

87. *See* Chelsea Harvey, *New York, California Lead State Efforts on Climate Change as Trump Retreats*, NEWSWEEK (Apr. 9, 2017, 12:10 PM), http://www.newsweek.com/new-york-california-state-efforts-climate-change-trump-retreats-580704.

88. SB 826, Section 2, adding §301.3(f)(2) to the Corporations Code. SB-826 requires a domestic general corporation or foreign corporation that is a publicly held corporation, as defined, whose principal executive offices are located in California to have a minimum of (i) one female director, by the close of the 2019 calendar year and (ii) one to three female directors depending on the size of the board (one, if the size of the board is four or fewer; two, if the number of directors is five; and three, if the number of directors is six or more), by the close of the 2021 calendar year. The bill has two primary enforcement mechanisms. First, the bill requires California's Secretary of State to publish reports on its web page documenting the number of corporations in compliance with these provisions as well as the number of corporations that moved out of California into another state during the preceding calendar year. Second, the bill authorizes California's Secretary of State to impose fines for violations of the bill. The bill has drawn both applause and criticism. For further background on the bill, see THOMAS CLARK & SANDRA NAKAGAWA, ASSEMBLY COMMITTEE ON JUDICIARY, STAFF REPORT ON SB 826, HEARING OF JUNE 26, 2018, at 1 (noting that "this bill, while certainly laudable and well-intended, raises considerable constitutional questions as well as more practical questions of implementation"). For an influential critical account of the bill, see, e.g., Joseph A. Grundfest, *Mandating Gender Diversity in the Corporate Boardroom: The Inevitable Failure of California's SB 826* (Rock Ctr.

B. Where Existing Corporate Long Arm Statutes Fall Short

It is unsurprising that the two states that have a long arm provision in their corporation laws are two of the most commercially significant states:[89] New York[90] and California.[91] The policy rationales underlying these corporate long arm statutes are two-fold: The first is to put domestic and foreign corporations that are doing business in their states on equal footing.[92] The second is to protect the interests of their residents that are impacted by foreign corporations. And this power to regulate a foreign corporation falls squarely within a host state's nearly unilateral[93] power to prevent any foreign corporation from doing business within its state.[94]

The New York and California long arm statutes provide that certain provisions of the New York Business Corporation Law (NYBCL) and

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for Corp. Governance at Stanford Univ. Working Paper No. 232, 2018), https://ssrn.com/abstract=3248791 ("Because of the internal affairs doctrine, SB 826 is unconstitutional as applied to all but 72 publicly traded corporations headquartered in California."). However, as explained here and as others have also argued, the internal affairs doctrine is not a constitutional rule. States have the authority to require foreign corporations transacting business in its state, including requiring such foreign corporations to comply with specified provisions applicable to domestic corporations. See *supra* note 48 and *infra* notes 92–94, and accompanying text.

89. *Delaware Corporate Law: Facts and Myths*, DELAWARE.GOV, https://corplaw.delaware.gov/facts-and-myths/ (last visited Dec. 19, 2018) ("In terms of total entity formations per year, Delaware consistently ranks among the top five states, along with Florida, California, New York, and Texas.").

90. N.Y. BUS. CORP. LAW §§ 1319, 1320 (McKinney 2018).

91. CAL. CORP. CODE § 2115 (West 2018).

92. California's corporate long arm statute originates from California's constitution, CAL. CONST. art. XII, § 15 (repealed 1972)—"[n]o corporation organized outside the limits of this State shall be allowed to transact business within this State on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this State."

93. The power is not absolute as it is subject to the corporation's right to engage in interstate commerce which is protected by the Commerce Clause of the U.S. Constitution and the Full Faith and Credit Clause of the U.S. Constitution (which requires that a state give full faith and credit to the corporate statute of the home state). GERARD CARL HENDERSON, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW 112–14 (1918); Richard M. Buxbaum, *Delaware Supreme Court Finds the State-of-Incorporation Version of the Internal Affairs Doctrine Embedded in the United States Constitution*, 15 CAL. BUS. L. REP. 173, 174 (1994).

94. Kaplan, *supra* note 13, at 442 n.22 (referring to the four cardinal principles that apply to foreign corporations: "(1) A corporation, being a creature of law, cannot exist outside the boundaries of the state of incorporation. (2) Being a creature of law, a corporation can nowhere exercise powers not granted it either by its charter or by the general laws of the state of incorporation. (3) A state is under no obligation to adhere to the doctrine of comity and hence has the power not only to refuse recognition to the foreign corporation but also to prevent the corporation from acting within its territory. . . . (4) [A] state is under no obligation to accord a foreign corporation the privileges which are enjoyed by its individual citizens . . . ." (quoting E. CHEATHAM, E. GRISWOLD, W. REESE & M. ROSENBERG, CASES AND MATERIALS ON CONFLICT OF LAWS 1007 (5th ed. 1964))).

California Corporations Code (CACC), respectively, will apply to foreign corporations doing business in their respective states. The list of NYBCL and CACC provisions that could potentially apply to a foreign corporation fall squarely within the scope of internal affairs. They include: the election, removal, and replacement of directors; directors' standard of care; limitations on corporate distributions; liability of directors and shareholders; and voting rules.

California's version of the corporate long arm statute provides that foreign corporations will be subject to certain selected provisions of California corporate law if they meet specified tests.[95] First, the statute looks at the weighted average of a corporation's property, sales, and payroll taxes.[96] Second, it looks at the percentage of voting securities that are held by California residents.[97] The California component (expressed as a percentage of companywide totals) must be greater than 50% in both cases in order for the long arm provision to be triggered.[98]

New York's long arm is set up as a negative application. New York's corporate long arm statute does *not* apply to a foreign corporation if "[l]ess than one-half of the total of its business income for the preceding three fiscal years, or such portion thereof as the foreign corporation was in existence, was allocable to [the state of New York] for franchise tax purposes under the tax law."[99]

In addition, while California looks at the preceding fiscal year, New York looks at the preceding three fiscal years. And unlike California, which considers a weighted average of multiple factors, New York looks only at one factor—business income—which is easy to measure, but is only a crude measure of New York's interest in the internal affairs of a foreign corporation doing business in its state.

While there are some differences in the formula and application, at their core, the California and New York approaches are similar in that both states use a one-formula-fits-all approach to decide whether the long arm statute is

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95. The newly enacted board diversity requirement in the California Corporations Code applies to any foreign corporation that is a publicly held corporation whose principal executive offices are located in California. CAL. CORP. CODE § 301.3(f)(2) (West 2018) (effective Jan. 1, 2019). This bill, which was approved during the final phase of this Article's revisions, reflects the recommendations set forth in the Article by moving away from a one-formula-fits-all approach and being more tailored in its application.

96. CAL. CORP. CODE § 2115(a)(1).

97. *Id.* § 2115(a)(2).

98. *Id.*

99. N.Y. BUS. CORP. LAW § 1320(a)(2) (McKinney 2018) (Exemption from Certain Provisions).

triggered. In addition, both corporate long arm statutes exclude companies listed on a national securities exchange from their scope, unless otherwise specified.[100] This is based on the theory that these corporations are national in character and therefore not an appropriate subject for local control.[101]

One of the major design flaws of existing corporate long arm statutes is their bluntness, which makes them both under- and overinclusive. If a corporation satisfies all of the tests specified in the long arm statute, all of the provisions of the long arm statute apply. However, if a corporation fails to satisfy any one of the prongs of the specified tests, none of the provisions of the long arm statute apply. Such an approach does not allow room to consider how the host state interest relates to the particular internal affair or to offer tailored justifications for the application of host state rules to internal affairs.

I argue that this blunt approach of the California and New York corporate long arm statutes prevents these corporate long arm statutes from doing much of their intended work. The major flaw of the existing corporate long arm statutes is that the specified tests which trigger the long arm are not tailored to the host state's interest in reaching the internal affairs of foreign corporations. This overreach has also made these corporate long arm statutes more vulnerable to constitutional challenges.[102]

The bluntness also makes the tests easy to avoid and under-inclusive in their application. A foreign corporation doing business in California can avoid the application of the California long arm by dialing down its contact on any one of the dimensions of the specified tests regardless of the nature of the internal affairs to which the long arm would otherwise apply. Also, the single-pronged nature of the New York test means that a company that receives just under 50% of its business income from the host state will be able to entirely avoid the application of the long arm provision.

A second design flaw of the existing corporate long arm statutes that I identify is that they compare the stakes of the host state to companywide totals, rather than to the stakes of the home state. This formulation has the benefit of simplicity, as it looks to whether or not the California or New York factors (as defined in the statutes) of the subject corporation exceed 50% (or not). However, in my view, this is the wrong test because it is grossly under-inclusive. While it is clear that a company that satisfies the specified tests of

100. CAL. CORP. § 2115(c); N.Y. BUS. CORP. § 1320.

101. Edwards, *supra* note 22, at 25–26 (arguing that corporations listed on a national exchange should be excluded from the reach of section 2115 because it is already subject to federal disclosure requirements); *see also* Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 862–63 (Ct. App. 1982) (discussing the rational basis for legislature's exclusion of nationally-listed corporations from the reach of section 2115). Public companies will not be excluded under my proposal.

102. *See infra* Part IV.A.2.

the California and New York long arm statutes require a special consideration, this test reaches only a subset of the cases to which the long arm should extend.

Coming back to the example of Farmers, the Nevada corporation, if the concern is that Nevada law has gone too far towards laxity compared to other states, what we should care about when determining whether California or New York protections should apply to Farmers is whether there are more California or New York citizens than Nevada citizens who have a stake in the content of those protections. The California and New York corporate long arm statutes as currently written look at whether there are more California or New York citizens who are stakeholders in the corporation than all other states combined. This is another reason why the corporate long arm statutes do not extend far enough and thus fail, as currently written, at realizing their full promise.

C. Proposed Corporate Long Arm Statute and Its Application

This subpart offers some solutions to address the shortcomings of existing corporate long arm statutes that were discussed in the previous subpart. First, the triggers for the application of the corporate long arm statute should not be constants. Instead, the corporate long arm statute that I propose first looks at the category of internal affairs to determine the type of contact that could potentially trigger the application of the long arm statute to that particular situation. The proposed corporate long arm statute first considers who the intended beneficiary of the missing protection is to determine the relevant trigger. For example, if the missing provision is one that limits the remedies for shareholders who are also creditors, the trigger should look to the corporation's contact with the shareholders who are also creditors residing in the home state.

Second, the proposed corporate long arm statute compares the host state's stake to the home state's stake with respect to the specific internal affair at issue. Under my proposal, the corporate long arm is triggered when the stakes of host state stakeholders (who are the intended beneficiaries of the missing protection) exceed the stakes of their home state counterpart. The main difference between the proposal and the existing regime is that the proposal compares the host state stakes to home state stakes (rather than that of all other states combined).

I return again to Farmers, the Nevada corporation with significant California contacts, to highlight the differences between the existing and proposed corporate long arm statutes. In deciding whether a particular California rule intended to benefit minority shareholders should extend to

Farmers, CACC section 2115 as currently written looks at whether the California portion of Farmer's investor, sales, payroll, and property factors exceeds 50%.[103] Under the framework I propose, the relevant consideration should be whether there are more minority shareholders residing in California than in Nevada.

This method gets to the heart of the mismatch of incentives that critics fear could generate a race to the bottom in the competition for corporate charters. Their concern is that the Nevada Legislature's apathy to the interests of the shareholders of a corporation like Farmers may result in a lax regime that deprives these shareholders of protections that are available elsewhere. The corporate long arm as envisioned in this Article provides Farmers' investors the benefit of the California protection if they can show that there are more California minority interests than Nevada minority interests in Farmers that are implicated by the missing protection for minority investors.

Does this mean that companies must comply with the local rules of every state from which it draws more stakeholders than from its state of incorporation? The answer would be no. If the California rule referenced in the prior paragraph represents the most protective position, the competition of whose substantive laws should apply on this particular issue will be one between Nevada and California.

Of course this attempt to mix and match protections based on the degree of their protectiveness comes with costs, and the corporate long arm statute that I propose considers the disruptive impact that the extension of the long arm may have on other stakeholders and on corporate planning. Disruptive impact includes the cost of determining which rules apply, the cost of applying the host state rules, and the costs borne by other stakeholders.

To summarize, the proposed corporate long arm statute can be broken down into three steps:

> <u>Step 1</u>. The first step of the analysis identifies the subject matter of the host state protections that a beneficiary is seeking to invoke through the corporate long arm provision: What protections are available under the host state regime that are not available under the home state regime, and what is the extent of the difference?[104] Who are the intended beneficiaries of the

103. CAL. CORP. § 2115(a)(2).

104. P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 10 (1985) ("The greater the diversity of corporate law, the more important becomes the choice of the law to apply . . . .").

host state protections, and what is the underlying policy of the host state protections?[105]

Step 2. The second step considers the host state and home state interests that are being implicated: What is the extent of the corporation's contact with the intended beneficiaries who are citizens of the host state? If these host state interests exceed the corporation's contact with the intended beneficiaries who are citizens of the home state, the corporate long arm statute may apply with respect to this particular subject matter.

Step 3. The last step considers the disruptive impact that the corporate long arm may have on interstate commerce, such as the cost of determining which rules apply and the cost of applying the host state rules (at the exclusion of the host state rules). The final calculus should consider the magnitude of such costs compared to the benefit of providing the missing protection. This step of the analysis should also take into account the benefits as well as costs to other stakeholders (other than the intended beneficiaries).

The balance of this Part provides four examples of the proposed corporate long arm statute's application.

1. Removal of Directors by Court Proceedings (California v. Nevada)

I begin with a simple example that concerns the removal of directors. We return to Farmers, a Nevada corporation, and consider the availability of a California shareholder protection that Nevada corporate law does not contemplate.

CACC section 304 provides that:

> The superior court of the proper county may, at the suit of shareholders holding at least 10 percent of the number of outstanding shares of any class, remove from office any director in case of fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation and may bar from reelection any director so removed for a period prescribed by the court.[106]

105. Kaplan, *supra* note 13, at 437 ("If the state which does not issue the charter does not have a public policy of sufficient importance or firmness to safeguard and protect its interests in such a situation, then there may be no justification for criticizing chartering activity of the incorporating state, in the face of the other state's disinterest or apathy.").

106. CAL. CORP. CODE § 304 (West 2018) (removal of directors by court proceedings).

Nevada does not provide for such removal of directors by court proceedings.

The internal affairs doctrine provides that Nevada law, as the law of the state of incorporation, governs the internal affairs of Farmers. The California and New York corporate long arm statutes do not apply, as while there are significant numbers of California and New York stakeholders in Farmers, neither exceed the 50% threshold contained in the specified tests of the California and New York corporate long arm provisions.

What would be the result under the proposed corporate long arm statute regime? The three-step analysis proceeds as follows:

Step 1. The intended beneficiary of CACC section 304 are the shareholders of the corporation who have suffered as a result of the misconduct of the offending directors.

Step 2. So long as there are more California shareholders than Nevada shareholders (in each case excluding the shares of the offending directors) holding the outstanding shares of any class, CACC section 304 could potentially be made available to any 10% (or greater) block of Farmers shareholders of such class.

Step 3. The disruptive impact of the long arm statute is minimal given the narrow scope of CACC section 304 which applies only in the case of director fraud, dishonesty or gross abuses of authority or discretion.[107] It would be disingenuous for the defendant to argue that the difference between whether California or Nevada (or some other) law applies to this issue of director removal would have had a meaningful impact on their behavior or on interstate commercial activities.

In this case, the rights provided to shareholders under CACC section 304 would be made available to holders of least 10% of the number of outstanding shares of Farmers under the proposed regime.

2. Shareholder Voting (California v. Delaware)

This second example considers a conflict between California and Delaware corporate law, which is the more likely scenario. As anecdotal

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107. *See* IP Telesis, Inc. v. Velocity Networks, Inc., No. CV 11-09950-RGK (AJWx), 2012 WL 12886966, at *3 (C.D. Cal. June 25, 2012) (discussing the application of CACC section 304 to cases that rise to the level of fraud and abuse); Starbird v. Lane, 21 Cal. Rptr. 280, 285–86 (Ct. App. 1962) (holding that general claims of fraud and abuse are not sufficient for removal of corporate directors, instead a plaintiff must show concrete examples); *see also* Remillard Brick Co. v. Remillard-Dandini Co., 241 P.2d 66, 77 (1952) (declining to remove directors for fraud and abuse after directors won reelection).

evidence, a search of the fifteen largest private companies with headquarters in California shows that five of fifteen (bolded) are incorporated in Delaware:[108]

Company	State of Incorporation
Kaiser Foundation Health Plan, Inc.	California
OptumRx, Inc.	California
WFC Holdings Corporation	**Delaware**
Pacific Gas and Electric Company	California
Advantage Sales and Marketing Inc.	**Delaware**
American Honda Motor Co., Inc.	California
Platinum Equity, LLC	California
Pacificare Health Plan Administrators, Inc.	Indiana
Nestle Holdings, Inc.	**Delaware**
AECOM Global II, LLC	**Delaware**
Farmers Group, Inc.	Nevada
California Physician's Service	California
Sutter Health	California
DFC Holdings, LLC (Agriculture, parent company of Dole Foods)	Kansas
Seagate Technology LLC	**Delaware**

The internal affairs doctrine provides that Delaware law governs the internal affairs of these and other Delaware corporations. The corporate long arm statute is a statutorily-created exception to the internal affairs doctrine. The proposed long arm statute would apply California rules even to a Delaware entity if the relevant California interest outweighs the relevant Delaware interests.

The facts of a Delaware Supreme Court case, *VantagePoint Venture Partners v. Examen, Inc.*, supplies an example of a Delaware to California contest.[109] Examen, Inc. (Examen) was a Delaware corporation, and VantagePoint Venture Partners (VantagePoint) was a venture capital firm

108. MERGENT-INTELLECT DATABASE (2018), http://www.mergentintellect.com/index.php/advancesearch/criteria/company (add filter "public private" and select "private" to obtain total active private companies, then add filter "California" to obtain active private companies in that state).

109. VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 (Del. 2005).

that had purchased Examen's preferred stock.[110] The subject of the dispute was the voting requirements for a proposed merger.[111]

Under section 1201(a) of the CACC, each class is entitled to a separate class vote on a proposed merger.[112] If California rules applied, VantagePoint would have been able to block the proposed merger. Examen satisfied the CACC section 2115 specified tests, and therefore under California law, CACC section 1201(a) (and other rules that are specified under CACC section 2115) applies to this case. However, the Delaware Supreme Court applied Delaware law (rather than California law), relying on constitutional principles.[113]

Under the corporate long arm statute I propose, the three-step analysis proceeds as follows:

Step 1. The intended beneficiary of CACC section 1201(a) are the preferred shareholders who are entitled to vote as a separate class thereunder.

Step 2. So long as there are more California preferred shareholders than Delaware preferred shareholders whose rights are implicated by the unavailability of the California rule, the California requirement that stockholders vote as a separate class may be available pursuant to the long arm.

Step 3. The disruptive effect of altering voting rules as well as the sophistication of the shareholders requesting the application of the long arm make this an unlikely set of facts to which the proposed corporate long arm statute would be extended.

The foregoing analysis highlights how the proposed corporate long arm is more reasoned and measured in its extension than the current California long arm provision.

3. Survival of Insider Trading Claims (California v. Delaware)

Another area of corporate law where California and Delaware have different rules is with respect to whether claims survive the departures of

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110. *Id.* at 1111.

111. *Id.* at 1108.

112. CAL. CORP. CODE § 1201(a) (West 2018).

113. *VantagePoint*, 871 A.2d at 1113 (holding that the internal affairs doctrine is a principle of constitutional law because Fourteenth Amendment Due Process mandates that "directors and officers of corporations 'have a significant right . . . to know what law will be applied to their actions' and '[s]tockholders . . . have a right to know by what standards of accountability they may hold those managing the corporation's business and affairs'" (quoting McDermott Inc. v. Lewis, 531 A.2d 206, 217 (Del. 1987))).

offending directors and officers.[114] As an example, section 25502.5 of the CACC provides that an issuer may bring an insider trading action against former officers and directors of a foreign corporation and invoke the rule permitting issuers to collect treble damages from violators if the subject securities transactions took place in California.[115] Delaware does not provide for the same. Should California or Delaware rules govern this particular issue for an issuer that is organized in Delaware but with a California footprint? The three-step analysis proceeds as follows:

Step 1. The intended beneficiary of CACC section 25502.5 is the issuer. CACC section 25502.5 reflects California's long-standing and well-established intent to regulate both intrastate conduct and securities transactions under California rules even with respect to securities that are issued by foreign corporations.[116] The legislative concern of CACC section 25502.5 is to police conduct that is destructive to the public interest, going beyond "the more narrow interests of a corporation's shareholders."[117]

Step 2. So long as the California interests that are harmed by the actions complained of are greater than the corresponding Delaware interests, section 25502.5's permissions to sue and collect treble damages could potentially be made available to a Delaware issuer (or to shareholders bringing a derivative suit on behalf of the issuer). The extent of the California interests is measured by the number of contemporaneous trades occurring in California at the time.

Step 3. As for the disruptive impact, it would here too (much like the first example) be disingenuous for the defendant to argue that the difference between whether California or Delaware (or some other) law applies in this case would have had any impact on their behavior or corporate planning. Furthermore, the expansively articulated public policy of CACC section 25502.5 and the view that the victims of insider trading fraud are more than just contemporaneous traders of that particular security, but rather all participants in the marketplace,[118] makes this an appropriate affair to which the corporate long arm should apply.

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114. Some other examples where the states' rules differ include mandatory cumulative voting (vs. straight voting), corporate survival statutes, ease of charter amendments, preemptive rights for shareholders, piercing the corporate veil, rights to bring a wrongful termination claim, permissions to sue and rights of indemnification for directors and officers. In some cases states may have the same rule but a different penalty, or the same rule but more clearly articulated standard by which the rule will be applied.

115. CAL. CORP. CODE § 25502.5.

116. *See, e.g.*, Friese v. Superior Court, 36 Cal. Rptr. 3d 558, 570–71 (Ct. App. 2005).

117. *Id.* at 571.

118. Peter J. Henning, *Determining the Victims of Insider Trading*, N.Y. TIMES (Nov. 11, 2013), https://dealbook.nytimes.com/2013/11/11/determining-the-victims-of-insider-trading/.

4. Multilateral Competition

The three examples offered thus far contemplated a bilateral competition. The more realistic case, however, is where multiple foreign host states are in play. In multilateral competitions, the steps of analyses will be the same, except that the three-step analysis would need to proceed in multiple rounds on a host-state by host-state basis.

In each round of analysis, we compare the home state and host state's interests that are implicated, and evaluate them in light of the disruptive impact on the corporation that would result from applying that host state's laws at the exclusion of the home state's laws.

For each relevant host state we consider: Does this host state's interests on this particular issue exceed the home state's interest? Do the benefits of applying this host state's protections exceed its disruptive impact? If the answers to both questions are yes, the corporate long arm would make that particular protection available to its intended beneficiaries.

If as a result of these multi-round analyses, multiple host states' laws could potentially apply, the most protective regime among them (i.e., the regime that is most preferred by the intended beneficiaries who are seeking the application of the long arm) will ultimately prevail. This example demonstrates the power of the proposed corporate long arm statute to engineer a race to the top in setting corporate law. These are the same results that would be reached if the competition for corporate charters were indeed a race to the top from the perspective of the intended beneficiaries of the otherwise missing protections.

The commercial reality is that shareholders are dispersed, and their interests are diffuse. This multilateral regime requires multiple rounds of analysis, which raises concerns about costs of navigating and applying the proposed corporate long arm regime. These and other counterarguments are considered in the next Part.

IV. OBJECTIONS, COUNTERARGUMENTS, AND COMPARISON TO OTHER ALTERNATIVES

Corporate long arm statutes have been criticized for being administratively burdensome, unconstitutional, and distorting market mechanisms. In subpart A, I outline, address, and respond to each of these objections. In subpart B, I consider whether other proposed alternatives (such as a federal solution) do better than the proposed corporate long arm statute in these respects.

A. Objections and Counterarguments

1. Administrative Burden

The main objection to the existing corporate long arm statutes has been that they are administratively burdensome. Some have argued that the burden rises to the level of an unconstitutional burden on interstate commerce.[119]

What are the related costs? First, the existing corporate long arm provisions in the California and New York corporate codes require annual testing of the California and New York factors of a company's business.[120] Although the specified tests appear to be straightforward, the question of how to apportion business income has been subject to administrative dispute.[121] Second, if the tests are satisfied, the corporation would have to comply with California or New York laws.[122]

While the corporate long arm statute I propose here does not do much better (and arguably does worse as it requires more frequent and tailored analysis than the existing statutes[123]), it does a better job at justifying this administrative burden. As explained earlier in Part III, the proposed corporate long arm will only be extended when the benefits advanced by the otherwise unavailable protections outweigh any disruptive impact. In addition, even if the internal affairs doctrine applied without exception, corporate planners must always be cognizant of the laws of states other than the state of their incorporation. Notably, the internal affairs doctrine does not apply where the rights of third parties external to the corporation are at issue.[124]

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119. *See infra* Part IV.A.2.

120. *See* Adam R. Moses, Haig Maghakian & Mark Vible, *Of Long Arms and Internal Affairs*, CORP. COUNS. (Dec. 23, 2014), https://www.milbank.com/images/content/1/8/v5/18692/Of-Long-Arms-and-Internal-Affairs-A-Moses-H-Maghakian-M-Vibl.pdf (discussion of the increased costs and uncertainty imposed on businesses by corporate long arm statutes); *see generally* VEDDER, PRICE, KAUFMAN & KAMMHOLZ, P.C., LONG-ARM STATUTES: A 50-STATE SURVEY (2003), http://euro.ecom.cmu.edu/program/law/08-732/Jurisdiction/LongArmSurvey.pdf (discussing the costs associated with compliance and additional litigation cost concerns of state long-arm statutes).

121. *See* JEFFREY M. VESELY & PRENTISS WILLSON, CALIFORNIA: SOURCING AND OTHER APPORTIONMENT ISSUES, COST 37TH ANNUAL MEETING 1 (2006), https://www.pillsburylaw.com/images/content/1/8/v2/1891/3E2484882AE2AD5F1E224FFC0602DA56.pdf.

122. *See supra* note 15 and accompanying text.

123. *See infra* pp. 1093–94 for an outline of the steps of analyses under the proposed model corporate long arm statute. *Cf.* Kaplan, *supra* note 13, at 468 ("It must be admitted that the evoking of public policy as a basis for decision usually introduces uncertainty into the law and brings litigants into a difficult and amorphous area.").

124. VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1113 (Del. 2005).

2. Constitutional Challenges

Another pushback to the existing corporate long arm statutes has been their tension with the internal affairs doctrine.[125] In some cases, this has led to constitutional challenges to both the California[126] and New York[127] corporate long arm regimes, and courts are split on this issue.[128]

One argument is that the corporate long arm statutes create uncertainty as to the laws that apply and thus could be considered an unconstitutional interference in violation of the Fourteenth Amendment Due Process Clause.[129] This argument that management has a right to know what laws apply was accepted by the Delaware Supreme Court in *VantagePoint*, and a Delaware corporation was able to avoid the application of California rules to its internal affairs on this basis.[130]

The corporate long arm statute proposed here may also be susceptible to such challenges. However, the Supreme Court has recognized that a state has an interest not only "in promoting stable relationships among parties involved in the corporations it charters," but also "in ensuring that investors in such corporations have an effective voice in corporate affairs."[131] These two values may sometimes be in tension with one another. While the internal affairs doctrine is unrivaled in its ability to advance the first of these two values, the concern is that it is not effective in furthering the second of these two values, and at times may interfere with efforts to give investors (and other stakeholders) an effective voice in corporate affairs. The corporate long arm statute can fill this gap by providing stakeholders with a tool to voice their

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125. *See, e.g.*, Grundfest, *supra* note 88, at 3–4 ("Section 2115 is a state statute. It cannot over-ride the internal affairs doctrine, which is of constitutional dimension. Therefore, to the extent that Section 2115 also interferes with the internal affairs of a corporation chartered outside of California, Section 2115 is also unconstitutional.").

126. *Cf.* W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 727 (Ct. App. 1961) ("It would appear that the provisions of the Corporate Securities Act here before us are a proper exercise of legislative discretion in requiring that corporate dealings with residents of this state be authorized by the Commissioner of Corporations, particularly where such corporation does a substantial amount of business within the state, and the act is not violative of the constitutional clauses of equal protection, contract, due process and full faith and credit if such legislative enactments operate equally upon such foreign corporations and domestic corporations in this state.").

127. *Cf.* Kaplan, *supra* note 13, at 447 ("[I]t seems reasonably clear that the full faith and credit clause does not bar a state, which has a substantial connection with a foreign corporation, from applying its law to the internal affairs of a foreign corporation in the manner, for example, set forth in Chapter 13 of the New York Business Corporation Act of 1961.").

128. For a detailed discussion of the constitutional and conflict of laws issues involved in the choice of law governing internal corporate affairs in the context of takeovers, see for example, Kozyris, *supra* note 104, at 30–46.

129. *Id.*

130. *VantagePoint*, 871 A.2d at 1113, 1114–15.

131. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 91 (1987).

preference for an alternative regime to apply to the internal affairs of the corporations in which they have a vested interest.

In addition, the corporate long arm statute proposed here does better than the existing framework in overcoming constitutional challenges by explicitly considering these competing values in the last step of the analysis. Recall that in the third step, the long arm becomes unavailable when burdens placed on interstate commerce exceed the local interests served by the host state regulation.

3. Opt-In by States

Another challenge to realizing the full promise of the proposed corporate long arm statute is the difficulty of incentivizing states to opt in to the proposed regime. Ultimately, the long arm strategy proposed in this Article requires host states' action as well as competency. These are not easy tasks as evidenced by the current state of the corporate long arm—only two states have maintained an operable version of the corporate long arm statute, and even those two states have considered repealing, or have been urged to repeal, their corporate long arm statutes due to operational and legal challenges.[132]

What are the incentives of the individual states to opt in to the regime I propose here? For one, a state has an interest in attracting corporations to its state and maximizing related revenues.[133] Second, a state has an interest in protecting the residents of its state who are also corporate stakeholders. The critique of the current competition for corporate charters has been that the chartering incentives have dwarfed the stakeholder protection rationale, especially in states like Nevada.

How well would the proposed long arm statute fare in advancing these two state interests? A long arm statute does poorly on both dimensions when it goes too far and corporations have no choice but to move out of that state altogether. For example, if a state were to adopt a strict liability regime for breaches of fiduciary duty owed to investors, firms will choose to not only incorporate elsewhere but may, in an extreme case, also eliminate contacts with that state altogether to avoid triggering the long arm provision. Under this scenario, the only states that will be able to avoid this exodus are the

132. Jeffrey Selman & J.R. Eppler, *Cutting Down California's Long Arm Statute*, LAW360 (July 11, 2012), https://www.crowell.com/files/Cutting-Down-Californias-Long-Arm-Statute.pdf.

133. *See supra* Part II.A.

states that are so commercially significant that companies cannot afford to exit from them.[134]

On the other hand, a long arm statute that goes just far enough to make it worthwhile for a company to consider reincorporating into the host state would be appealing from both the chartering and protectionist perspectives. This is the scenario where Farmers decides that the uncertainty from having both Nevada (its home state) and California (a state from which it draws significant investments) laws apply makes it worthwhile for it to reincorporate in California and subject it to California rules. In this case, the potential application of the long arm provision may incentivize corporations to opt in to more protective regimes to avoid the disruptive impact of the long arm statute. Alternatively, corporations could rewrite their charters to incorporate the more protective regime, assuming that the home state rules do not forbid it. In either case, the long arm statute will have done its intended work of facilitating or accelerating a race to the top from the perspective of the beneficiaries of the relevant protection.

Admittedly, the long arm statute cannot do its work if it is easily avoided. Yet, policing avoidance is costly. And while open-ended standards and flexible methodologies are useful in supplementing the mechanical rigidity of the internal affairs doctrine, they come at the expense of certainty, predictability, and ease of application.[135]

4. Private Ordering and the Freedom of Contract

Another potential weakness of the proposed corporate long arm to consider is the disruptive impact that the corporate long arm statute may have on private ordering and the freedom of contract. This view regards the decision of where to incorporate, and the resulting consequences of whose laws will govern internal affairs, as representing the bargain reached among all present and future stakeholders of the corporation.[136]

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134. In this sense, the recent proposal to split California into three states has a direct impact on the payoffs of the proposed corporate long arm statute. For more information on the proposed ballot measure, see CAL3, https://cal3.com/ (last visited Dec. 18, 2018).

135. This is all to say that an empirical study of the impact of the long arm will be needed to ensure that the corporate long arm statute can succeed as a strategy to reduce the negative spillovers that arise from the competition for corporate charters. This study should also consider the increased costs of compliance and potential manipulation. One could imagine a California-based activist investor threatening to buy up stock in a company to pressure management to trigger a California long arm.

136. This view is consistent with the classical view of corporations as a "nexus of contracts" and that the charters and bylaws represent a contractual agreement between directors and

While it is generally accepted that corporate charters are contracts, contracts are subject to the common law principles of interpretation. One example of such a principle is that if there is any doubt as to the meaning of a contract term, an interpretation against the party that supplied the term is preferred.[137] In the case of corporate charters, it is the incorporators and managers that draft the initial charter and bylaws and choose the state of the company's incorporation.[138] If considered an adhesion contract, the non-drafting party's reasonable expectation about the content of the charter may replace what is actually contained therein.[139] The content of laws that apply to internal affairs would then turn on a factual inquiry of whether the home or some other state's rules are most consistent with the non-drafting party's expectations.[140]

The reasonable expectations doctrine is intended to incentivize drafters to draw attention to and clarify any ambiguities about the contract terms at the outset, and the corporate long arm proposal further reinforces these incentives. Under my proposal, a beneficiary that has given informed consent to a particular provision could not later avail itself of the long arm provision to argue that another state's rules should apply to that particular affair. In this way, the corporate long arm lends further legitimacy and consistency to the contractarian view of corporate charters.

Another way to reconcile my proposal with the contractarian view of corporate charters would be to view the long arm provision as a separate contract between the corporation and the host state (acting as the agent of its

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shareholders of where to incorporate. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 12 (1991); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 871 (2005).

137. *Contra Proferentem*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/contra_proferentem (last visited Dec. 19, 2018) (defining *contra proferentem*, a term "used in contract law referring to the principle that a judge will construe an ambiguous term against the party that imposed the inclusion of the term in the contract during negotiation or drafting").

138. For example, in Delaware, unless explicitly provided for otherwise, shareholders do not have the power to reincorporate the corporation without the recommendation of the board. *See* DEL. CODE ANN. tit. 8, §§ 241, 251 (West 2018).

139. The reasonable expectations doctrine, most commonly invoked in the insurance context, has been used to protect the expectations of the parties to contracts. Robert H. Jerry, II, *Insurance, Contract, and the Doctrine of Reasonable Expectations*, 5 CONN. INS. L.J. 21, 30 (1998) ("Reasonable expectations have long played a decisive role in contract interpretation.").

140. In the case of less sophisticated stakeholders, these stakeholders are less likely to be aware of interstate differences and their reasonable expectation of protections are likely connected to their state of personal residence rather than the state of the corporation's state of incorporation. *Cf.* Stevens, *supra* note 22, at 1070 ("By investing in a corporation, shareholders are selecting the laws of a given state—the state of incorporation—to regulate the affairs of a corporation and to protect them if such a need arises.").

residents).[141] Host states have wide authority to regulate the conduct that occurs within their borders or affects their residents, and use this authority to extract bargains from companies desiring to do business in their state. For example, companies that need the California Department of Business Oversight (DBO) Commissioner's approval for a major transaction from time to time have agreed to provide a representation that transaction will not injure California stockholders.[142] In these cases, it could be said that the firm has been put on notice that certain California provisions may apply to them, which in turn minimizes the disruptive impact of the long arm.

By the same token, stakeholder requests to apply home state laws should also be respected. For example, the New York Court of Appeals in *Greenspun v. Lindley* found it compelling that the shareholders voluntarily came together under a declaration calling for application of the state of incorporation's laws.[143] These principles would still carry over to the proposed regime. For the corporation to enjoy this immunity from the corporate long arm statute, it would need to show that it has provided the information required for shareholders to make such a declaration on an informed and voluntary basis. In this way, the proposed corporate long arm incentivizes corporations to provide ex ante disclosures to, and to engage in more deliberative contracting with, stakeholders regarding the substance of laws that govern corporate internal affairs.

B. Comparison to Other Proposed Alternatives

One benefit of the proposed long arm strategy is its versatility. Most proposals for reforming the corporate chartering process require agreement on which direction the competition for corporate charters is headed, but this is one debate on which corporate scholars cannot seem to agree.[144] The federalization solution for instance presumes that the race among states for corporate charters is one to the bottom. Full reliance on the internal affairs doctrine on the other hand presumes that the race among states for corporate

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141. This view extends Henry Hansmann's view of the corporate charter as a contract not only between the managers and shareholders but also the home state, by adding host states as additional parties thereto. *See* Hansmann, *supra* note 72, at 2.

142. California is unique in that both the Corporations Code and Corporate Securities Law are administered by the California Corporations Commissioner. This has resulted in California state securities laws having a broader reach than those of other states, e.g., including with respect to what constitutes a "sale" of new stock that requires a permit by the Commissioner. W. Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 727 (Ct. App. 1961).

143. Greenspun v. Lindley, 330 N.E.2d 79, 80 (N.Y. 1975).

144. *See supra* Part II.B.

charters is one to the top. The long arm strategy I propose does not require buy in on either side of this enduring and unresolved debate in corporate law.

In the remainder of this subpart, I explain how the corporate long arm statute strategy is also more politically feasible and cost effective compared to other reforms that have been proposed as alternatives to the current corporate chartering regime.

1. Federal Charter

Of the many possible federal alternatives, one proposal that has been given some serious consideration is the federal incorporation statute.[145] This alternative has received renewed attention in connection with the Accountable Capitalism Act proposed by Senator Elizabeth Warren, which contemplates, among other things, the creation of a federal corporate regulator and chartering agency.[146] Under the federal incorporation regime, corporations would have the option to obtain their charter from the federal government and for these national corporations, Congress would set the laws which govern the internal affairs of federal corporations.[147] This regime has been proposed as a potential solution to the race to the bottom based on the idea that the federal government, given its scale and scope, would not be swayed by charter dollars and would have incentives that are aligned with most domestic shareholders.[148] State legislatures would have neither legislative nor enforcement authority over federally-chartered corporations.[149]

The benefit of a federal alternative compared to the long arm strategy is its preemption power.[150] If the federal statute includes a preemption clause

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145. Roe, *supra* note 24, at 597 ("From time to time, serious talk arises of federal chartering of firms in interstate commerce. This proposal, although not realistic today, arose three times in the twentieth century before fading away . . . ."); *see also* Sung Hui Kim, *The Failure of Federal Incorporation Law: A Public Choice Perspective*, *in* CAN DELAWARE BE DETHRONED? EVALUATING DELAWARE'S DOMINANCE OF CORPORATE LAW 16, 22–23 (2017) (describing attempts by Progressives in the 1900s and 1910s to amend the Sherman Antitrust Act to provide for a federal corporate charter).

146. *See supra* note 25 and accompanying text.

147. MARTIN J. SKLAR, THE CORPORATE RECONSTRUCTION OF AMERICAN CAPITALISM 1890–1916, at 188 (1988).

148. George Dent, *For Optional Federal Incorporation*, 35 J. CORP. L. 499, 499–500 (2010).

149. McCulloch v. Maryland, 17 U.S. 316, 436 (1819) (holding that states cannot constitutionally control the powers of entities created under federal law).

150. Professors Bratton and McCahery have argued that the mere possibility of federal preemption is enough to keep Delaware in check. William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, 621 (2006)

explicitly withdrawing specified powers from the states, there is express preemption. Otherwise, the federal statute preempts state law with which it actually conflicts. There is a direct conflict if compliance with both the state and federal law is impossible, and there is an indirect conflict if state law stands as an obstacle to accomplishment and execution of full purposes of objectives of Congress.[151]

The dual banking regime that provides banks with the option of either a federal or state charter is often looked to as a model.[152] However, banking experts largely view the dual banking regime as a product of accident and happenstance that makes it difficult to replicate in other contexts, including the market for corporate charters.[153]

2. Regulating Foreign Qualifications and Reincorporations

Early corporate practice required incorporation or reincorporation in a state as a prerequisite to doing business in that state.[154] Such an express requirement that forces companies to incorporate as a separate entity in each state it wishes to do business is operationally much more burdensome than the corporate long arm that is proposed in this Article.

A similar suggestion that does not go quite as far has been to heighten foreign qualification standards. I consider the corporate long arm strategy to be one kind of foreign qualification standard, rather than an alternative to it.[155] A corporation doing business in a foreign state accepts conditions placed upon it by local law, and the operation of the corporate long arm statute proposed here would be one such condition. Such conditions are consistent with the broad regulatory power that states have to regulate conduct occurring

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("It follows that a state with Delaware's incentives would not be tolerated as a de facto national lawmaker absent the possibility of federal preemption to reverse or modify state law results.").

151. Caleb Nelson, *Preemption*, 86 VA. L. REV. 225, 226–228 (2000).

152. *See generally* COMPTROLLER OF THE CURRENCY, NATIONAL BANKS AND THE DUAL BANKING SYSTEM (2003), https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/national-banks-and-the-dual-banking-system.pdf.

153. RICHARD S. CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, THE LAW OF FINANCIAL INSTITUTIONS 12 (5th ed. 2013) ("The dual system remains a distinctive feature of American banking law, although by now the accident of its birth is often forgotten.").

154. Kaplan, *supra* note 13, at 444–45.

155. *Id.* at 445 ("Another device for control over foreign corporations is to demand as a condition of entry that the applicant corporation agree to be bound by specified provisions (with respect to which there is presumably a strong public policy) of the state's domestic corporation act.").

within its borders and to regulate foreign corporations under the same standard as domestic corporations.[156]

One could also consider expanding the scope of extraordinary actions to include reincorporation as an action that cannot be taken without majority shareholder action. Under current Delaware law, extraordinary actions include liquidations, dissolutions, mergers, consolidations, or sales or dispositions of all or substantially all of an entity's assets.[157] I question the practical impact of such an expansion given the existing data on reincorporations which suggests that the initial choice of the state of incorporation is a sticky one and there are actually very few reincorporations that occur each year.[158]

3. Reconsidering the Internal Affairs Doctrine

This last alternative brings us back to where we began—the internal affairs doctrine.[159] Proponents of the internal affairs doctrine will argue that the better solution is to repeal the California and New York long arm statutes because they create new problems without solving old ones. While I acknowledge that the long arm statutes that are currently in use have serious flaws, the fact that they have stirred up some controversy is evidence that there are material matters on which home and host states differ that stakeholders care about.[160] The concern with the internal affairs doctrine, as

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156. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 371–385 (West 2018) (Foreign Corporations); MODEL BUS. CORP. ACT § 15.05(b) (AM. BAR ASS'N 2011) ("A foreign corporation with a valid certificate of authority has the same but no greater rights and has the same but no greater privileges as, and except as otherwise provided by this Act is subject to the same duties, restrictions, penalties, and liabilities now or later imposed on, a domestic corporation of like character.").

157. *See, e.g.*, DEL. CODE ANN. tit. 8, § 275(b) (West 2018) (Dissolution); *id.* § 251(c) (Mergers); *id.* § 271(a) (Asset Sales); *id.* § 266(b) (Conversions).

158. *See* Eldar & Magnolfi, *supra* note 66, at 1.

159. Kozyris, *supra* note 104, at 51 (describing the lack of a better alternative as one of the advantages of the internal affairs doctrine).

160. The following cases involve a challenge to the application of CACC Section 2115: *In re* Vandevort, 2007 WL 7540971 (B.A.P. 9th Cir. Mar. 27, 2007); Nagy v. Riblet Prods. Corp., 79 F.3d 572 (7th Cir. 1996); Saratoga Advantage Tr. Tech. & Commc'ns Portfolio v. Marvell Tech. Grp., Ltd., 2016 WL 4364593 (N.D. Cal. Aug. 16, 2016); Voss v. Sutardja, 2015 WL 349444 (N.D. Cal. Jan. 26, 2015); Johnson v. Myers, 2011 WL 4533198 (N.D. Cal. Sept. 30, 2011); *In re* Verisign, Inc., Derivative Litig., 531 F. Supp. 2d 1173 (N.D. Cal. 2007); *In re* Flashcom, Inc. 308 B.R. 485 (C.D. Cal. 2004); *In re* Sagent Tech., Inc., Derivative Litig., 278 F. Supp. 2d 1079 (N.D. Cal. 2003); *In re* Mahoney, 80 B.R. 197 (S.D. Cal. 1987); Greb v. Diamond Int'l Corp., 295 P.3d 353 (Cal. 2013); Inv'rs Equity Life Holding Co. v. Schmidt, 183 Cal. Rptr. 3d 219 (Ct. App. 2015); Simon v. Stang, 2013 WL 3482701 (Cal. Ct. App. July 11, 2013); Robinson v. SSW, Inc., 147 Cal. Rptr. 3d 230 (Ct. App. 2012); Lidow v. Superior Court, 141 Cal.

demonstrated earlier, is that it may resolve differences in favor of managers, generating or reinforcing what critiques fear to be a "race to the bottom" in the competition for corporate charters. The proposed long arm statute forces the consideration of other stakeholder interests by inviting interested host states to the corporate law setting process.

Furthermore, one could argue that the definition of internal affairs, together with the definition of corporate stakeholders, is evolving.[161] The recent surge of do-it-yourself legal websites such as Rocket Lawyer and LegalZoom have opened the door to incorporators of varying levels of sophistication, and the check-the-box nature of these platforms suggest that the internal affairs doctrine's strict adherence to the state of incorporation's laws may overstate the significance of the incorporator's choice of its state of incorporation.[162] Instead, the place where most of the business affairs are conducted or where most of the intended beneficiaries of legal protections reside might be the best governor of certain internal affairs.[163] This flexible approach brings corporate law more in line not only with modern chartering trends but also with how conflicts of law are resolved in other areas of law.[164]

Rptr. 3d 729 (Ct. App. 2012); Henry v. Edgell, 2011 WL 3687377 (Cal. Ct. App. Aug. 23, 2011); Kruss v. Booth, 111 Cal. Rptr. 3d 56 (Ct. App. 2010); Vaugh v. LJ Int'l, Inc., 94 Cal. Rptr. 3d 166 (Ct. App. 2009); Smead v. Danzi, 2009 WL 808467 (Cal. Ct. App. Mar. 30, 2009); Brutto v. Chin, 2008 WL 2191772 (Cal. Ct. App. May 28, 2008); Friese v. Superior Court, 36 Cal. Rptr. 3d 558 (Ct. App. 2005); Alison v. Danilovic, 2004 WL 2797988 (Cal. Ct. App. Dec. 7, 2004); State Farm Mut. Auto. Ins. Co. v. Superior Court, 8 Cal. Rptr. 3d 56 (Ct. App. 2003); Havlicek v. Coast-to-Coast Analytical Servs., Inc., 46 Cal. Rptr. 2d 696 (Ct. App. 1995); N. Am. Asbestos Corp. v. Superior Court, 225 Cal. Rptr. 877 (Ct. App. 1986); Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852 (Ct. App. 1982); Finkel v. First Exec. Corp., 1991 WL 256089 (Cal. Super. Ct. May 28, 1991); VantagePoint Venture Partners 1996 v. Examen, 871 A.2d 1108 (Del. 2005); Tera Sys., Inc. v. Mentor Graphics Corp., 2003 WL 23341841 (Del. Ch. Aug. 22, 2003).

161. *See, e.g.*, DEL. CODE ANN. tit. 8, § 115 (West 2018) (defining "internal corporate claim"); 80 Del. Laws, c. 40, § 5 (2015) ("'Internal corporate claims' means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.").

162. ROCKET LAWYER, https://www.rocketlawyer.com/ (last visited Dec. 19, 2018); LEGALZOOM, www.legalzoom.com (last visited Dec. 19, 2018).

163. Kaplan, *supra* note 13, at 467 ("[T]urning away from the rigid rule of the law of the state of incorporation may indicate a possible route for governing foreign corporations by the law of the state where their activities are primarily conducted, rather than by the law arbitrarily chosen by the entrepreneurs who created the entity.").

164. Corporate law's approach to resolving conflicts of laws (i.e., internal affairs doctrine) has persisted as an anomaly within the modern conflict of law system which has moved toward interest analysis. *See supra* note 48 and accompanying text.

V. CONCLUSION

The main contribution of this Article is to recognize the innovation that corporate long arm statutes bring to corporate governance by inviting host state interests to the corporate law-setting framework. The corporate long arm, if properly designed and implemented, is expected to not only raise the floor but also raise the ceiling in the competition for corporate charters.

In response to the concern that victor states will be too lax toward managers, the corporate long arm statute avoids the falling out of the bottom by applying stricter host state laws to the corporation in certain cases. In this way, the "race to the bottom" scenario is where the corporate long arm statute can do the most work.

The corporate long arm statute is still useful in the cases where the competition for corporate charters generates a race to the top. The long arm provision functions as a check and balance on the dominant state and can influence the parameters of the race itself. As substantive doctrines of different states become less important due to the long arm, states will have to compete on the efficiency of their process.

In this way, the corporate long arm statute proposed here is expected to engineer the result that race to the bottom camp desires and to maintain the result that race to the top camp believes has already been produced by the competition for corporate charters among U.S. states.

APPENDIX A: CAL. CORP. CODE § 2115 (THROUGH 2013 LEG. SESS.)

> (a) A foreign corporation (other than a foreign association or foreign nonprofit corporation but including a foreign parent corporation even though it does not itself transact intrastate business) is subject to the requirements of subdivision (b) commencing on the date specified in subdivision (d) and continuing until the date specified in subdivision (e) if:
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> (1) The average of the property factor, the payroll factor, and the sales factor (as defined in Sections 25129, 25132, and 25134 of the Revenue and Taxation Code) with respect to it is more than 50 percent during its latest full income year and
>
> (2) more than one-half of its outstanding voting securities are held of record by persons having addresses in this state appearing on the books of the corporation on the record date for the latest meeting of shareholders held during its latest full income year or, if no meeting was held during that year, on the last day of the latest full income year. The property factor, payroll factor, and sales factor shall be those used in computing the portion of its income allocable to this

state in its franchise tax return or, with respect to corporations the allocation of whose income is governed by special formulas or that are not required to file separate or any tax returns, which would have been so used if they were governed by this three-factor formula. The determination of these factors with respect to any parent corporation shall be made on a consolidated basis, including in a unitary computation (after elimination of intercompany transactions) the property, payroll, and sales of the parent and all of its subsidiaries in which it owns directly or indirectly more than 50 percent of the outstanding shares entitled to vote for the election of directors, but deducting a percentage of the property, payroll, and sales of any subsidiary equal to the percentage minority ownership, if any, in the subsidiary. For the purpose of this subdivision, any securities held to the knowledge of the issuer in the names of broker-dealers, nominees for broker-dealers (including clearing corporations), or banks, associations, or other entities holding securities in a nominee name or otherwise on behalf of a beneficial owner (collectively "nominee holders"), shall not be considered outstanding. However, if the foreign corporation requests all nominee holders to certify, with respect to all beneficial owners for whom securities are held, the number of shares held for those beneficial owners having addresses (as shown on the records of the nominee holder) in this state and outside of this state, then all shares so certified shall be considered outstanding and held of record by persons having addresses either in this state or outside of this state as so certified, provided that the certification so provided shall be retained with the record of shareholders and made available for inspection and copying in the same manner as is provided in Section 1600 with respect to that record. A current list of beneficial owners of a foreign corporation's securities provided to the corporation by one or more nominee holders or their agent pursuant to the requirements of Rule 14b-1(b)(3) or 14b-2(b)(3) as adopted on January 6, 1992, promulgated under the Securities Exchange Act of 1934, shall constitute an acceptable certification with respect to beneficial owners for the purposes of this subdivision.

(b) Except as provided in subdivision (c), the following chapters and sections of this division shall apply to a foreign corporation as defined in subdivision (a) (to the exclusion of the law of the jurisdiction in which it is incorporated):

Chapter 1 (general provisions and definitions), to the extent applicable to the following provisions;

Section 301 (annual election of directors);

Section 303 (removal of directors without cause);

Section 304 (removal of directors by court proceedings);

Section 305, subdivision (c) (filling of director vacancies where less than a majority in office elected by shareholders);

Section 309 (directors' standard of care);

Section 316 (excluding paragraph (3) of subdivision (a) and paragraph (3) of subdivision (f)) (liability of directors for unlawful distributions);

Section 317 (indemnification of directors, officers, and others);

Sections 500 to 505, inclusive (limitations on corporate distributions in cash or property);

Section 506 (liability of shareholder who receives unlawful distribution);

Section 600, subdivisions (b) and (c) (requirement for annual shareholders' meeting and remedy if same not timely held);

Section 708, subdivisions (a), (b), and (c) (shareholder's right to cumulate votes at any election of directors);

Section 710 (supermajority vote requirement);

Section 1001, subdivision (d) (limitations on sale of assets);

Section 1101 (provisions following subdivision (e)) (limitations on mergers);

Section 1151 (first sentence only) (limitations on conversions);

Section 1152 (requirements of conversions);

Chapter 12 (commencing with Section 1200) (reorganizations);

Chapter 13 (commencing with Section 1300) (dissenters' rights);

Sections 1500 and 1501 (records and reports);

Section 1508 (action by Attorney General);

Chapter 16 (commencing with Section 1600) (rights of inspection).

(c) This section does not apply to any corporation (1) with outstanding securities listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market, or (2) if all of its voting shares (other than directors' qualifying shares) are owned directly or indirectly by a corporation or corporations not subject to this section.

(d) For purposes of subdivision (a), the requirements of subdivision (b) shall become applicable to a foreign corporation only upon the

first day of the first income year of the corporation (1) commencing on or after the 135th day of the income year immediately following the latest income year with respect to which the tests referred to in subdivision (a) have been met or (2) commencing on or after the entry of a final order by a court of competent jurisdiction declaring that those tests have been met.

(e) For purposes of subdivision (a), the requirements of subdivision (b) shall cease to be applicable to a foreign corporation (1) at the end of the first income year of the corporation immediately following the latest income year with respect to which at least one of the tests referred to in subdivision (a) is not met or (2) at the end of the income year of the corporation during which a final order has been entered by a court of competent jurisdiction declaring that one of those tests is not met, provided that a contrary order has not been entered before the end of the income year.

(f) Any foreign corporation that is subject to the requirements of subdivision (b) shall advise any shareholder of record, any officer, director, employee, or other agent (within the meaning of Section 317) and any creditor of the corporation in writing, within 30 days of receipt of written request for that information, whether or not it is subject to subdivision (b) at the time the request is received. Any party who obtains a final determination by a court of competent jurisdiction that the corporation failed to provide to the party information required to be provided by this subdivision or provided the party information of the kind required to be provided by this subdivision that was incorrect, then the court, in its discretion, shall have the power to include in its judgment recovery by the party from the corporation of all court costs and reasonable attorneys' fees incurred in that legal proceeding to the extent they relate to obtaining that final determination.

APPENDIX B: N.Y. BUS. CORP. LAW §§ 1319–1320 (2015)

1319. Applicability of other provisions.

(a) In addition to articles 1 (Short title; definitions; application; certificates; miscellaneous) and 3 (Corporate name and service of process) and the other sections of article 13, the following provisions, to the extent provided therein, shall apply to a foreign corporation doing business in this state, its directors, officers and shareholders:

(1) Section 623 (Procedure to enforce shareholder's right to receive payment for shares).

(2) Section 626 (Shareholders' derivative action brought in the right of the corporation to procure a judgment in its favor).

(3) Section 627 (Security for expenses in shareholders' derivative action brought in the right of the corporation to procure a judgment in its favor).

(4) Sections 721 (Exclusivity of statutory provisions for indemnification of directors and officers) through 727 (Insurance for indemnification of directors and officers), inclusive.

(5) Section 808 (Reorganization under act of congress).

(6) Section 907 (Merger or consolidation of domestic and foreign corporations).

1320. Exemption from certain provisions

(a) Notwithstanding any other provision of this chapter, a foreign corporation doing business in this state which is authorized under this article, its directors, officers and shareholders, shall be exempt from the provisions of paragraph (e) of section 1316 (Voting trust records), subparagraph (a)(1) of section 1317 (Liabilities of directors and officers of foreign corporations), section 1318 (Liability of foreign corporations for failure to disclose required information) and subparagraph (a)(4) of section 1319 (Applicability of other provisions) if when such provision would otherwise apply:

(1) Shares of such corporation were listed on a national securities exchange, or

(2) Less than one-half of the total of its business income for the preceding three fiscal years, or such portion thereof as the foreign corporation was in existence, was allocable to this state for franchise tax purposes under the tax law.