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ABSTRACT

To the modern corporate scholar and lawyer, the internal affairs doctrine seems in the natural order of things. Corporate law is state law. Each corporation is formed under the law of its chosen state of incorporation. To ensure consistency and predictability, that law must govern the corporation's internal affairs. Yet the origin of such a doctrine is puzzling. Respecting the firm's choice of corporate law, the doctrine forces state legislatures into competition to attract incorporations. But how did legislatures come to concede their traditional territorial regulatory authority, and instead agree to compete? This Article solves this puzzle, offering the first account of the doctrine's surprising origins.

Widespread acceptance of the internal affairs doctrine among U.S. states assures that a firm's choice of corporate law will be respected outside the incorporating state. According to the dominant paradigm, this respect for firm choice creates a common market for corporate law, enabling regulatory competition. Both proponents and critics of competition agree that state legislatures compete—or at least have competed—to sell corporate charters to raise state revenues. In the debate over state competition, all sides take the internal affairs doctrine as a given. But if legislators compete to maximize private benefits in the form of state revenues, why do states recognize foreign corporation law at all? How did state legislatures ever come to surrender their traditional territorial jurisdiction, and instead agree to a choice of law convention forcing them into direct competition?

To date, the puzzle of the internal affairs doctrine has been overlooked. The doctrine's existence has been taken for granted, requiring little in the way of comment, criticism, or explanation. I explain the unexpected origins of the doctrine and its persistence through the early years of modern charter competition in the early part of the twentieth century. This historical analysis shows that the doctrine's origin had nothing to do with regulatory competition. Instead, it emerged before state charter competition, at a time when firms had little choice about where to incorporate. Competition came later, under circumstances radically different from those under which the doctrine was first articulated. That the earlier-crafted doctrine later facilitated regulatory competition was hardly by design. Instead, its path to facilitating modern charter competition depended on a fortuitous sequence of events, driven by ideology, interest group influences, and institutional inertia. This story of historical contingency debunks common assumptions about the emergence of the doctrine, which modern corporate scholars implicitly view to have been inevitable.

I. INTRODUCTION

> Every State in this country has enacted laws regulating corporate governance . . . . Large corporations that are listed on national exchanges, or even regional exchanges, will have shareholders in many States and shares that are traded frequently. The markets that facilitate this national and international participation in ownership of corporations are essential for providing capital not only for new enterprises but also for established companies that need to expand their businesses. This beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.[1]

To the modern corporate scholar and lawyer, the internal affairs doctrine seems in the natural order of things. Corporate law is state law. Each corporation is formed under the law of its chosen state of incorporation. To ensure consistency and predictability, that law must govern the corporation's internal affairs.[2] But the origin of such a doctrine is puzzling. Respecting the firm's choice of corporate law, the doctrine forces state legislatures into competition to attract incorporations. But how did legislatures come to concede their traditional territorial regulatory authority, and instead agree to compete? This article solves this puzzle, offering the first account of the doctrine's surprising

1. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89-90 (1987).

2. Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (1985).

> To many corporate lawyers, the "internal affairs" doctrine—the notion that only one state, almost always the site of incorporation, should be authorized to regulate the relationships among a corporation and its officers, directors, and shareholders—is irresistible, if not logically inevitable. Convenience and predictability of application, it is said, dictate that one body of corporate law govern internal affairs, while the most plausible state to supply that law is the state of incorporation, to whose legislative grace the corporation owes its legal existence.

Id. (citations omitted).

origins. In so doing, it also raises an important challenge to regulatory competition proposals generally, which are all the rage today, and which often look to U.S. corporate law as their prototype.

For disputes over a corporation's internal affairs—the relations among a firm's shareholders and managers—states generally apply the law of the incorporating state. The widespread acceptance of this doctrine enables a firm to incorporate under the law of any state, knowing its choice will be respected elsewhere. According to the prevailing wisdom, this respect for firm choice creates a common market for corporate law. It treats corporate law as a product and sparks regulatory competition among the states.[3]

Both proponents and critics of corporate regulatory competition have long held that state legislatures compete to sell corporate charters in order to raise state revenues.[4] In this debate, the internal affairs doctrine is taken as a given. Scholars further agree that corporate law has largely been shaped by legislators' and firm managers' pursuit of their own private benefits. With these assumptions, however, a question arises: why do maximizing legislators recognize foreign corporation law at all? How did state legislatures ever come to surrender their traditional territorial regulatory jurisdiction in this one area of law, and instead agree to a choice of law convention forcing them to compete? In short, why did states allow firms to *choose* their corporate law?

Lawmakers ordinarily legislate with a territorial reach. Nations, states, and other political subdivisions are based on territorial borders—identifiable boundaries—and

3. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1-13 (1993) (noting firm choice of corporate law independent of physical presence and resulting state competition); Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 697 (1984) ("Because only one state's law governs the 'internal affairs' of a corporation, competition can be effective."); Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151, 1162 (2000) (describing role of internal affairs doctrine in enabling jurisdictional competition over corporate law); Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675, 702-03 (2002) (describing relation between internal affairs doctrine and regulatory competition); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation* 107 YALE L.J. 2359, 2408 (1998) (noting relation between internal affairs doctrine and regulatory competition); David A. Skeel, *Rethinking the Line Between Corporate Law and Corporation Bankruptcy*, 72 TEX. L. REV. 471, 521 (1994) (noting that the internal affairs doctrine is a "crucial component" of state charter competition); Michael J. Whincop and Mary Keyes, *The Market Tort in Private International Law*, 19 NW. J. INT'L L. & BUS. 215, 266 (1999) ("[The internal affairs doctrine] has formed the basis of jurisdictional competition for incorporations in the United States.").

4. *See* sources cited *infra* note 33. A recent strand in the literature argues that states no longer compete—at least not vigorously—but that Delaware now dominates the market. Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Debate on State Competition over Corporate Charters*, 112 YALE L.J. 553 (2002) (applying industrial organization theory to explain why states do not compete with Delaware); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002) (arguing that states do not compete with Delaware, and political considerations are the reason why). These scholars recognize, though, that states have in the past competed. Scholars have also recently begun to debate the significance of the *federal* government's influence on the content of state corporate law. In recent papers, Mark Roe has argued that the federal government has significant—and perhaps dominant—influence on the content of U.S. corporate law, and therefore that the state competition debate has been misguided. Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491 (2005); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003). Roberta Romano disputes Roe's thesis, asserting the continuing significance of competition among states. Roberta Romano, *Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?* (Yale Law Sch., Ctr. for Law, Econ. and Pub. Policy, Paper No. 307, 2005), *available at* http://ssrn.com/abstract=693484.

lawmakers generally enjoy prescriptive authority within their borders.[5] In the microeconomic parlance, they enjoy a certain monopoly on law. The monopoly might be contested, of course. More than one jurisdiction may assert its power to prescribe rules to govern a particular activity or transaction. Within this contest, however, it is highly unusual for a sovereign voluntarily to forswear its prescriptive jurisdiction over activity that occurs wholly or predominantly within its own territory. Especially given the rich returns enjoyed first by New Jersey,[6] and later by Delaware, as the primary purveyor of corporate charters to public companies,[7] legislatures' long-standing deference to firm choice seems puzzling. Here, monopolists willingly foreswore their respective monopolies to allow their markets to be contested. Why not instead mandate local law for firms engaging in local business?

Granted, too heavy a regulatory hand might discourage firms from doing business in a state. But in other areas of regulation, the conventional response to such competitive pressure is to adjust the *substance* of the regulation to mitigate its burden—not to allow firms to opt out in favor of other law. Jurisdictions adjust their tax laws, their tort laws, or their workers' compensation laws in response to firms' grumblings. But they do not leave it to firms to *choose*. Offering opt-out seems extreme.

Much ink has been spilled in the debate over corporate charter competition and its social welfare implications.[8] Yet to date, the puzzling nature of the internal affairs doctrine has been overlooked. Though it has long been the dominant rule among the states,[9] the doctrine's existence has been taken for granted, requiring little by way of comment, criticism, or explanation. Its origins have gone unexplored.

In this Article, I address this puzzle. I explain the origins of the internal affairs doctrine and its persistence through the early years of modern charter competition in the early part of the twentieth century.[10] This historical analysis reveals that the doctrine's origin had nothing to do with regulatory competition. The doctrine emerged before state charter competition did, at a time when firms had little choice about where to incorporate. Firms ordinarily incorporated in their home states—where their operations were located and where their organizers lived. In this context, the deference to the incorporating state embodied in the internal affairs doctrine merely recognized each state's territorial sovereignty over local firms. The doctrine did not vindicate private choice, since firms *had no choice* about where to incorporate. Instead, at its genesis, the internal affairs doctrine simply allocated territorial regulatory authority among sovereigns—a useful function for regulatory monopolists. Competition came later, under circumstances radically different from those under which the doctrine was first articulated. Only with the rise of large interstate firms, and with New Jersey's pioneering strategy of actively

5. In a federal system, regulatory overlap among different levels of government may be common, but even then, law, constitutions, and custom tend to delineate which level of political authority may regulate particular issue areas.

6. *See infra* notes 243-248 and accompanying text.

7. *See infra* notes 30-32 and accompanying text.

8. *See infra* notes 33-35 and accompanying text.

9. *See* Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137 (1955) (stating that "local" corporations have been incorporating in other states for favorable law for many years); DeMott, *supra* note 2.

10. The doctrine's continuing persistence after the early part of the twentieth century is the subject of a subsequent Article.

marketing charters to firms with no economic ties to the state, did the internal affairs doctrine come to facilitate regulatory competition. That the earlier-crafted doctrine later facilitated state competition was hardly by design. Rather, its path to facilitating competition depended on a fortuitous sequence of events, driven by ideology, interest group influences, and institutional inertia.[11]

This story of historical contingency debunks common assumptions about the emergence of the doctrine, which modern scholars implicitly view to have been inevitable. Two conceptions of such inevitability seem particularly popular. Some scholars have argued that the doctrine has Constitutional origins.[12] These scholars assert that charter competition—and implicitly, the modern internal affairs doctrine—was a direct result of the Supreme Court's Commerce Clause decisions in the 1860s precluding states from regulating foreign corporations engaged in interstate commerce.[13] Other scholars suggest that the doctrine's modern functional advantages explain its emergence: because it offers consistency and predictability for firm managers and investors, and because it promotes efficient private ordering, the doctrine was foreordained. Since it makes sense in the modern context, the logic goes, the doctrine's widespread acceptance was inevitable.[14] My historical account undermines both these popular explanations.[15]

The Article is organized as follows. In Part II, I elaborate on the puzzling nature of the internal affairs doctrine. Parts III and IV together explain the doctrine's initial articulation by the courts. In Part III, I explain the historical ideological underpinnings of the doctrine. In Part IV, I describe courts' first enunciation of the internal affairs doctrine

11. My historical explanation applies the lessons of what Ron Harris has dubbed the Historical New Institutional Economics (HNIE). Ron Harris, *The Encounters of Economic History and Legal History*, 21 LAW & HIST. REV. 297 (2003). Eschewing functionalist approaches, HNIE focuses instead on the origins of institutions and the coalitions on which they are founded. Kathleen Thelen, *Historical Institutionalism in Comparative Politics*, 2 ANN. REV. POL. SCI. 369, 400 (1999). Timing matters. The historical view implies that rules and institutions embody the results of the temporal processes that led to their creation. Unintended consequences are commonly observed, and they often take on a life of their own. Lee J. Alston, *Empirical Work in Institutional Economics: An Overview*, *in* EMPIRICAL STUDIES IN INSTITUTIONAL CHANGE (Lee J. Alston et al. eds., 1996). These themes feature prominently in the following analysis.

12. *See infra* Part IV.D. Assertions of the doctrine's Constitutional underpinnings have taken another form as well. Some have argued that recent cases on state antitakeover statutes have Constitutionalized the doctrine under the Commerce Clause. *See infra* note 29. Recent takeover cases, of course, cannot explain the doctrine's origin.

13. *See infra* Part IV.D.

14. *See infra* Part II.A.

15. As for the 1860s Commerce Clause cases, I consider and reject arguments that these cases played a decisive role in generating charter competition or that they foreordained the modern internal affairs doctrine. I show instead that states retained significant power to regulate foreign corporations, but that political and economic conditions toward the end of the nineteenth century disfavored such regulation. *See infra* Part IV.D. Common functionalist explanations for the internal affairs doctrine likewise fail to explain the doctrine's origins. Indeed, functionalist approaches overlook the puzzle of the doctrine's origins entirely. The modern doctrine no doubt serves the ends of consistency and predictability, so familiar to contemporary discussion of corporate charter competition and implicitly sanctioned in *CTS*. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987). Similarly, its vindication of parties' private choice of law may offer efficiency gains. Identifying the doctrine's consequences, however, does not explain its causes. My historical account shows that the doctrine did not emerge to serve these functional goals, however desirable they may be in the modern context. Instead, the practice of charter competition evolved around the already extant internal affairs doctrine. *See infra* Part II.A.

in the mid-late nineteenth century and the territorial corporate law context in which this occurred. Part V describes the advent of modern charter competition and the new role for the internal affairs doctrine in enabling that competition. I first recount the great merger movement at the turn of the twentieth century and New Jersey's role in instigating modern law-as-a-product charter competition. I then explain the political economy of the early modern internal affairs doctrine—why state legislatures were willing to surrender their territorial prerogatives with respect to corporate law. I conclude in Part VI, pulling together the various historical strands to summarize the puzzle's solution and suggesting broader implications of this analysis.

II. THE PUZZLE OF THE INTERNAL AFFAIRS DOCTRINE

To corporate lawyers and corporate law scholars, the internal affairs doctrine seems unremarkable. It seems always to have been a part of the corporate law landscape. Modern justifications for the doctrine seem rational, and so it must ever have been thus.

But the internal affairs doctrine *is* remarkable. "The remarkable feature of the development of American law in this area was its openness and the willingness of the states to permit local entrepreneurs to incorporate elsewhere and thus to select the legal regime that would govern them."[16] In this part, I first summarize the modern doctrine. I then elaborate on its puzzling nature.

A. The Doctrine

In its modern form, the internal affairs doctrine is a choice of law rule, widely accepted among states,[17] that selects the law of the incorporating state to govern disputes over the corporation's internal affairs.[18] Corporate lawyers and corporate scholars take

16. William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303, 314 (1997).

17. A handful of states—California and New York most notably—impose their own local requirements on certain foreign corporations as to certain issues. *See* CAL. CORP. CODE § 2115 (2001); N.Y. BUS. CORP. LAW § 1317-1320 (2002).

18. McDermott, Inc. v. Lewis, 531 A.2d 206 (Del. 1987). The *Restatement (Second) of Conflicts of Laws* defines internal affairs as "the relations inter se of the corporation, its shareholders, directors, officers or agents—and hence likewise fall within the scope of the rules of §§ 303-310." RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. a (1971) [hereinafter RESTATEMENT (SECOND) OF CONFLICTS]. Internal affairs include:

> . . . steps taken in the course of the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, preemptive rights, the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, shareholders' rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganizations and the reclassification of shares. Matters which may also affect the interests of the corporation's creditors include the issuance of bonds, the declaration and payment of dividends, loans by the corporation to directors, officers and shareholders, and the purchase and redemption by the corporation of outstanding shares of its own stock.

Id. Specific internal affairs include determination of shareholders, *id.* § 303; shareholder participation in management and profits, *id.* § 304; voting trusts, *id.* § 305; liability of a majority shareholder, *id.* § 306; shareholder liability to the corporation and its creditors, *id.* § 307; and director and officer liability to the corporation, its creditors, and shareholders, *id.* § 309.

the doctrine for granted.[19] Its widespread acceptance among the states suggests the relative lack of controversy surrounding the rule.[20]

The standard rationales for the doctrine also seem simple and straightforward: the doctrine offers predictability for firms and their investors; it offers uniform treatment of all shareholders; it vindicates the parties' choice of law. Unlike more complex conflicts analyses used in other areas of law,[21] the internal affairs doctrine offers a consistent choice of law for firms and their investors, for whom certainty is said to be critical. Moreover, shares of stock within the same class are meant to enjoy identical rights. Disputes among corporate managers and shareholders would therefore seem to be an area where the same substantive rules must apply across the board. Different laws to govern identical disputes could place the parties in untenable positions.[22] In addition, the doctrine vindicates corporate managers' and shareholders' choice of governing law.[23]

To the extent commentators have attempted to explain the doctrine's existence, they have done so merely by pointing out these standard rationales. The doctrine makes sense. It functions well in promoting these various laudable goals. Enhancing the predictable enforcement of private choices, it is efficient.

> Under the prevailing conflicts practice, . . . [courts] have consistently applied the law of the state of incorporation to the entire gamut of internal corporate affairs. In many cases, this is a wise, practical, and equitable choice. It serves the vital need for a single, constant and equal law to avoid the fragmentation of continuing, interdependent internal relationships . . . . It validates the autonomy of the parties in a subject where the underlying policy of the law is enabling. It facilitates planning and enhances predictability . . . . [A]pplying local internal affairs law to a foreign corporation just because it is amenable to process in the

19. "[T]he lex incorporationis principle is generally treated as axiomatic." Kozyris, *infra* note 40, at 19.

20. "The doctrine is widely accepted and has become enshrined in the Revised Model Business Corporation Act as a statutory choice of law rule." Carney, *supra* note 16, at 314. The Model Act provides that it "does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state." MODEL BUSINESS CORPORATION ACT § 15.05(c) (1984). The official comment elaborates that this provision "preserves the judicially developed doctrine that internal corporate affairs are governed by the state of incorporation even when the corporation's business and assets are located primarily in other states." *Id.* § 15.05(c) cmt. The Model Act provision has been adopted by a number of states. Jennifer J. Johnson, *Risky Business: Choice-of-Law and the Unincorporated Entity*, 1 J. SMALL & EMERGING BUS. L. 249, 271-72 and n.86 (1997).

Some scholars have noted that the internal affairs doctrine is hardly uniformly followed. Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137 (1955) (collecting cases); Jed Rubenfeld, *State Takeover Legislation and the Commerce Clause: The "Foreign" Corporations Problem*, 36 CLEV. ST. L. REV. 355 (1988) (collecting cases and arguing that internal affairs doctrine is incoherent). However, even the cases that apply local law to a foreign corporation typically attempt to explain away the applicability of the doctrine—for example, by suggesting that the particular facts somehow do not implicate internal corporate affairs.

21. Absent effective choice by the parties, the general rule described in the *Restatement (Second) of Conflicts* requires the weighing of various factors in a search for the jurisdiction with the "most significant relationship" to the parties and transaction at issue. *See* RESTATEMENT (SECOND) OF CONFLICTS, *supra* note 18, §§ 6, 188.

22. For example, it is impossible for the corporation to honor inconsistent laws of two different jurisdictions regarding cumulative versus straight voting. DeMott, *supra* note 2, at 175-76.

23. Managers make an explicit choice by having selected the particular state of incorporation, and shareholders make an implicit choice by deciding to invest in that corporation. *See* sources cited *infra* note 40.

> forum or because it has some local shareholders or some other local contact is apt to produce inequalities, intolerable confusion, and uncertainty, and intrude into the domain of other states that have a superior claim to regulate the same subject matter.[24]

Describing the doctrine's functional consequences, however, does not explain its causes.

B. The Puzzle

Functional accounts of the internal affairs doctrine seem to suggest some rational design behind the doctrine. Roberta Romano, for example, locates the "genius" of American corporate law in its system of state charter competition. "[P]rivate parties are persistent in devising institutions that circumvent or minimize the effect of political constraints on economic development. The genius of American corporate law in this regard is that the dynamics of state competition reduces the number of extraneous regulations that must be bypassed."[25] On this view, the emergence of the internal affairs doctrine to facilitate competition would seem inevitable, a product of history's inexorable march to efficiency. From this efficiency perspective, it is difficult to imagine a different approach to corporate choice of law. The doctrine's existence must necessarily have resulted from its survival as the "fittest" institutional design, to be preferred against all others.[26]

From a political economy perspective, however, the existence of the doctrine leaves an awkward gap in the regulatory competition story for those who tell it. Race-to-the-top and race-to-the-bottom scholars agree that states and their legislatures compete to offer attractive corporate law in order to garner revenues from the sale of corporate charters. But as Adam Smith observed long ago,[27] and as every business person knows, sellers would rather not compete. Instead, they prefer protected markets. Unlike private sellers, states have a ready method of protecting their regulatory markets. They can legislate their own protection: they can mandate local corporate law for firms doing business within their borders.[28] Instead, however, since the late nineteenth century, these supposed

24. Kozyris, *infra* note 40, at 98; *see also* ROBERT LEFLAR ET AL., AMERICAN CONFLICTS LAW 700 (4th ed. 1986) (citing uniformity of shareholder treatment as justifying internal affairs doctrine); ROMANO, *supra* note 3, at 2403 (noting uniformity of treatment of shareholders as widely cited justification for internal affairs doctrine); 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, 509-10 (1989) ("Internal corporate affairs should be subjected to a unitary, cohesive, consistent, predictable, equal, and continuous regime of regulation."); Ribstein, *infra* note 40 (noting efficiency of internal affairs doctrine).

25. ROMANO, *supra* note 3, at 147.

26. *See generally* JAMES G. MARCH & JOHAN P. OLSEN, REDISCOVERING INSTITUTIONS 54 (1989) (describing efficient evolution view of history).

27. "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the publick, or in some contrivance to raise prices." ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 145 (R.H. Campbell et al. eds., Oxford Press 1976) (1776).

28. This might of course subject a multistate firm to inconsistent or excessive regulation, but that issue has not stopped individual states from regulating in all sorts of areas—employment law, environmental law, tort law, for example. To the extent a corporation might find it impossible to comply with inconsistent rules—regarding its internal corporate affairs or in some other area—it might just have to withdraw from doing

maximizing legislatures have allowed their markets to be contested. They have generally permitted firms to opt out of their local corporate law. They have condoned competition among states by acquiescing to the internal affairs doctrine. Why?[29] Modern functionalist explanations about consistency and predictability cannot account for the doctrine's origin or explain its persistence in facilitating charter competition.

As is well known, Delaware is the leading supplier of corporate charters for publicly traded companies in the United States. It finances a large proportion of its state budget through the franchise taxes it charges its incorporated firms.[30] Its consistent ability to generate hundreds of millions of dollars each year through the sale of corporate charters has attracted imitators, admirers, and critics.[31] Likewise, New Jersey enjoyed similar success and similar criticism as the original dominant purveyor of corporate charters before Delaware.[32]

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business in some states. Presumably, in this situation, the corporation would have to choose a compliance strategy that would enable it to remain doing business in its most economically advantageous set of states.

29. Some courts and commentators have suggested over the years that the internal affairs doctrine is constitutionally mandated. *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89-90 (1987) (hinting that internal affairs doctrine may be required under dormant Commerce Clause); Kozyris, *infra* note 40 (arguing that Full Faith and Credit Clause and dormant Commerce Clause mandate internal affairs doctrine); Robert E. Suggs, *Business Combination Antitakeover Statutes: The Unintended Repudiation of the Internal Affairs Doctrine and Constitutional Constraints on Choice of Law*, 56 OHIO ST. L.J. 1097, 1131 (1995) (asserting that *CTS* decision "strongly suggests" internal affairs doctrine is constitutionally required); *cf.* Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CAL. L. REV. 29 (1987) (discussing and opposing constitutionalization of internal affairs doctrine). In a bit of perhaps parochially motivated piling on, the Delaware Supreme Court has argued that the internal affairs doctrine is Constitutionally required under the Commerce Clause, the Full Faith and Credit Clause, and the Fourteenth Amendment. McDermott, Inc. v. Lewis, 531 A.2d 206, 216 (Del. 1987). However, because the doctrine is of much earlier vintage than any suggestion of Constitutional mandate, that cannot serve as a causal explanation. Moreover, no historical evidence appears to suggest that states viewed the internal affairs doctrine as a Constitutional mandate. *See infra* Part IV.C.

30. These fees account for more than 20% of Delaware state revenues. Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1566 (2002).

31. *See* Bebchuk & Hamdani, *supra* note 4, at 556 n.13 (noting that Delaware collected approximately $600 million in franchise fees in 2001).

Over the last century, various states have attempted to duplicate Delaware's success and steal some of its market share. Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 283 (1976) (describing efforts of various states from 1967 through 1976); Kahan & Kamar, *supra* note 4, at 693 & nn.41 & 42 (noting modern efforts of Nevada, Maryland, and Pennsylvania to compete with Delaware). None have had even modest success. In fact, just the opposite has occurred. Over time, Delaware has consolidated its position as the leading supplier of corporate charters for publicly traded companies. In 1965, Delaware was the most popular state of incorporation for companies traded on the New York Stock Exchange, accounting for 35% of those firms. Stanley A. Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 435 n.5 (1968). New York was second with 13%. *Id.* In 1974, 52 of the largest 100 industrial companies were Delaware corporations; 251 out of the largest 500, and 448 of the largest 1,000 were also Delaware corporations. Seligman, *supra*, at 283. These 448 accounted for over 52% of the sales of the largest 1,000 companies. *Id.* Today, Delaware accounts for 58% of all U.S. public company charters. Bebchuk & Hamdani, *supra* note 4, at 578. The vast majority of firms—97% percent of all U.S. public companies—incorporate either in their home state or Delaware. Daines, *supra* note 30, at 1562. Delaware's dominance is even more pronounced when the market for out-of-state incorporations is separately considered. Among firms choosing to incorporate outside their home state, 85% choose Delaware. Bebchuk & Hamdani, *supra* note 4.

32. *See infra* notes 243-248 and accompanying text. New Jersey lost its dominant position to Delaware when it voluntarily bowed out of the "charter-mongering" game in 1913. New Jersey governor Woodrow

Both admirers and critics of competition generally agree that some competition among states does occur—or at least *has* occurred—over corporate charter sales. While there is no general agreement about whether this competition has been for good or ill,[33] all sides recognize that a facilitative choice of law rule—the internal affairs doctrine—has enabled the competition.[34] However, the doctrine is taken as given. Scholars debate the myriad issues embedded in the "law as a product" idea and the analogy of political markets to product markets.[35] They debate whether firm managers are sufficiently constrained to pursue investors' welfare in their choice of corporate law. They debate whether and under what circumstances revenue incentives might spur legislatures into vigorous competition for corporate charters. They debate the intensity of competition and its effects in shaping states' corporate laws. But the choice of law rule that enables this competition has always been treated simply as an exogenous phenomenon—it just *is*.

But state legislatures control state choice of law rules just as they control substantive corporate law. If the terms of competition were not to a state's liking, why did they compete at all? A state legislature could simply have decided *not* to honor firms' choice of corporate law, but could have applied local corporate rules to all corporations doing some quantum of business in-state. Such a move would have discouraged at least the local firms from incorporating in Delaware—or New Jersey before it—since firms' chosen corporate law would not have been honored locally in any event. From the very

Wilson had won his bid to be President of the United States. In his last few months as governor, Wilson now had a national constituency to be concerned with. Responding to the widespread national criticism of New Jersey as the Traitor State, *see infra* Part V.A.2, Wilson pushed through the state legislature the famous "Seven Sisters" reforms that attempted to tighten up New Jersey's corporation code. CHRISTOPHER GRANDY, NEW JERSEY AND THE FISCAL ORIGINS OF MODERN AMERICAN CORPORATION LAW 81-82 (1993). This succeeded in driving all the New Jersey corporations to Delaware, which had been perhaps the most studious imitator of New Jersey's charter-mongering strategy. Delaware was at the time already poised to take over New Jersey's first-mover advantage, having adopted New Jersey's general incorporation statute essentially verbatim in 1899, and having had a state court declare in 1900 that in so doing, Delaware's legislature must have intended that its courts follow New Jersey precedents in interpreting the statute. Wilmington City Ry. Co. v. People's Ry. Co., 47 A. 245, 254 (Del. Ch. 1900). Only a few years later, New Jersey unwound Wilson's reforms in an attempt to get back into the chartering business. But the great corporations had gone to Delaware for good.

33. For thirty-odd years, corporate scholars have debated whether corporate charter competition benefits investors or only self-serving firm managers. This debate over corporate law's "race-to-the-top" versus "race-to-the-bottom" is a familiar one. Classic race-to-the-top works include FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" vs. Federal Regulation*, 53 J. BUS. L. 259 (1980); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913 (1982); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977). Race-to-the-bottom scholarship includes Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974); Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461 (1989); *see also* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995) (suggesting that network effects may impede race to the top); *cf.* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 498-509 (1987) (describing role of Delaware corporate bar in influencing Delaware corporate law).

34. *See supra* note 3 and accompanying text.

35. For the seminal account of the differences between political markets and product markets, see George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 10 (1971).

beginning of modern charter competition, a state legislature could have retained market share simply by refusing to recognize out-of-state incorporation.[36] Imposing local law would also have enabled legislators to strike their preferred balance among the various in-state interests affected by corporate law—firm managers, shareholders, creditors, employees, local communities, and competitors,[37] for example—instead of leaving it to firms to choose. Despite these various potential advantages for legislatures from imposing local corporate law, the internal affairs doctrine emerged and persisted.

C. Solving the Puzzle: Historical Context

Viewed as a snapshot—as an equilibrium captured in an instant in time—the internal affairs doctrine is a puzzle. Corporate scholars' standard assumption about maximizing legislators does not allow for legislators' widespread acceptance of a choice of law rule so seemingly inimical to their interests. Solving this puzzle requires a turn to history.

From the early days of charter competition to today, the modern internal affairs doctrine has operated in a specific context. Courts' deference to the law of the incorporating state has enabled regulatory competition only because a firm may incorporate under the law of any state to do business in every state. More particularly, (a) each state offers incorporation to any firm regardless of where the firm is physically located and where its organizers reside, and regardless of whether the firm has any other ties to its chosen state of incorporation; and (b) each state recognizes foreign corporations' corporate status and allows them to do business in-state—again without regard to whether such firms have substantive ties to their incorporating states.[38]

In the modern context, these features seem unremarkable. They seem part and parcel of the corporate law environment as we know it. However, it was not always thus. The internal affairs doctrine arose in the context of territorial corporate law. When courts first began to articulate the doctrine in the 1860s, firms had little choice about where to incorporate; they incorporated in their home states. Shopping for a corporate charter across multiple states was not an option, since a state typically expected or required its domestic corporations to maintain economic ties with the state. This expectation comported with the local nature of most businesses. Firms transacted primarily if not

36. Of course, this might just drive local firms to move out of state.

37. Contemporary conventional wisdom does not include firm-employee relations within the scope of corporate law or corporate internal affairs. However, recent proposals have called for their inclusion. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999). Alternative constituency statutes also expressly recognize employees as corporate stakeholders and permit managers to consider them in corporate decision making. *See* Comm. on Corporate Laws, *Other Constituency Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2260-63 (1990) (discussing alternative or "other" constituency statutes). Finally, traditional restrictions in nineteenth century corporate law can be understood to protect employees and other stakeholders. *See infra* Part IV.B.2.

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

> It thus 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. A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.

Id.

exclusively in local product, labor, and capital markets. A firm typically had an identifiable "center of gravity" in one state, and it incorporated there.[39] Each state legislature effectively enjoyed a captive market for its corporate law, which was restrictive in nature. Courts generally agreed that jurisdiction over corporations' internal affairs lay exclusively with the courts of the incorporating state. This doctrine served as a jurisdictional bar to courts outside the incorporating state and not merely a choice of law rule—though the courts of the incorporating state invariably applied local law to resolve internal affairs disputes. This deference to the incorporating state recognized each state's territorial sovereignty over its corporate entities. Initially, this judge-made rule was consistent with legislators' rent-seeking interests. It assured each legislature that sister states would not interfere with the legislature's existing state monopoly on corporate law. Ironically, the doctrine promoted *market sharing* among states with respect to corporate law, and not competition.[40]

Only later did competition over corporate law develop. A confluence of events, including the great merger movement at the end of the nineteenth century, led to modern corporate charter competition and a new role for the internal affairs doctrine in facilitating that competition.[41] New Jersey and other states began to grant charters to firms with which they enjoyed no substantive economic ties, and they began to price their charters to generate significant revenues.[42] Firms now enjoyed a range of choices for their state of incorporation,[43] and states had important political and financial incentives to offer enabling corporate law and to sell charters to all comers.[44] Only in this context—when firms could choose their state of incorporation—did deference to the incorporating state also mean deference to firms' choice of corporate law. Only then did the internal affairs doctrine serve to facilitate modern charter competition.

State legislatures could have revisited the doctrine at this point. After all, corporate law was no longer territorially bound, and the doctrine no longer vindicated states' territorial sovereignty or legislators' regulatory monopolies. On the contrary, respect for firm choice dissipated legislators' monopolies. It forced them to compete. Theoretically, legislatures could have excluded foreign corporations from doing intrastate business or attempted to impose local rules on those foreign corporations, thereby discouraging out-of-state incorporation. However, local interest group pressures and barriers to collective action among state legislatures foreclosed such a strategy.[45] Along with the merger movement came dramatic economic upheaval. Large interstate firms came to dominate

39. *See infra* notes 103-107.

40. This history contrasts with modern corporate contractualism, which closely associates the internal affairs doctrine with the vindication of party autonomy and free contracting. *See* P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 50 ("[T]he choice of the state of incorporation comes about by agreement among the organizers and its law is selected, explicitly or implicitly, to govern this private internal corporate relationship."); O'Hara & Ribstein, *supra* note 3, at 1202 (noting the internal affairs doctrine is consistent with, and lends support to, arguments justifying enforcement of choice-of-law clauses in other contexts); Larry E. Ribstein, *Choosing Law by Contract*, 18 J. CORP. L. 245, 266 (1993) ("[T]he 'internal affairs' rule . . . provides for general enforcement of contractual choice of law in corporations.").

41. *See infra* Part V.

42. *See infra* Part V.A.2.

43. *See infra* Part V.C.

44. *See id.*

45. *See infra* Part V.C.2.

national markets, and local interests in each state developed economic relationships with these firms. Legislatures could not afford to maintain restrictive corporate rules or impose them on foreign corporations. That would have risked driving business out of state to the detriment of local interests. Moreover, as it became clear that corporate law could no longer maintain any regulatory bite, legislatures substituted other territorially-based regulation to protect favored interest groups. Legislatures lost interest in rent seeking through corporate law.[46]

And courts perpetuated the internal affairs doctrine. Reminiscent of Cardozo's disdained "tyranny of tags and tickets,"[47] courts continued to parrot the earlier rationales, relying on notions of states' sovereignty over their domestic corporations, despite the fact that now the state of incorporation might have no substantive ties to "its" corporations. Institutional inertia preserved the basic notion of deference to the incorporating state,[48] but now with the consequence of promoting competition and not monopoly.

III. IDEOLOGICAL ORIGINS: TERRITORIAL SOVEREIGNTY OVER LOCAL FIRMS

Modern corporate charter competition began at the end of the nineteenth century with the great merger movement. It was then that the internal affairs doctrine first came to play its modern role in facilitating competition. However, the doctrine was originally articulated by courts in a very different context, earlier in the century before the advent of charter competition. During most of the nineteenth century, states did not compete to sell corporate charters but instead enjoyed territorial monopolies on corporate law. To understand how the modern internal affairs doctrine came ultimately to facilitate charter competition, we must study its initial articulation in this unfamiliar context. Its pre-merger movement evolution is the focus of this Part and the next. In this Part, I recount the pre-industrial ideological origins of the doctrine, which courts later echoed in their enunciation of the doctrine. The next Part describes the period of U.S. industrialization during which courts first articulated the doctrine.

The animating ideas behind the internal affairs doctrine were formed during the pre-industrial period—from the American Revolution to the middle of the nineteenth century. Before industrialization, businesses were small, predominantly family-run, local businesses. Most were run as partnerships, and those that incorporated did so in their home states.[49] Businesses transacted primarily in local product, labor, and capital markets, and rarely had operations out-of-state.[50] Foreign corporation questions rarely arose, as firms' activities were typically confined to their home states. States were generally assumed to enjoy territorial sovereignty over their domestic corporations.[51]

The conception of the corporation was also very different from its current conception. Incorporation was not generally available to all who applied; instead,

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46. *See infra* Part V.C.3.

47. Benjamin N. Cardozo, *Mr. Justice Holmes*, 44 HARV. L. REV. 682, 688 (1931).

48. *See generally* Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601 (2001) (discussing role of precedent in creating path dependent common law process).

49. *See infra* notes 103-105 and accompanying text.

50. *See infra* note 103 and accompanying text.

51. *See infra* Part III.C.

corporate charters were granted only sparingly, one-by-one, through special acts of state legislatures. Each act was specifically tailored to the particular project proposed, with powers and privileges specifically defined.[52] Not only were business corporations "creatures" of the state—in the sense that they came into existence through specific acts of state legislatures—but through the early part of the 19th century, they were viewed as *agencies* of the state. Like the other more popular types of corporations of the day—municipal, charitable, ecclesiastical, educational—business corporations were formed to pursue public purposes and were thought of as auxiliary organs of state government.[53]

This view of the corporation occasioned practices and associations between the corporation and state government that would be unthinkable today, when the business corporation is viewed primarily as a private profit-maximizing organization. Business corporations were typically granted special privileges or delegated government powers thought necessary to the accomplishment of the particular projects undertaken. For example, canal companies typically enjoyed eminent domain powers. States were also often actively involved in financing or overseeing the management of their corporations, investing state funds and taking board seats.

Given the close relations between state governments and the corporations they created, sovereignty considerations necessitated that each state should enjoy exclusive authority over the internal affairs of its corporations. In the aftermath of the Revolution, each new state jealously guarded its sovereign prerogatives. The later deference to the incorporating state embodied in the internal affairs doctrine—assuring each state singular control over the internal governance of its business corporations—followed naturally from these sovereignty concerns. Writing in 1933, one commentator noted:

> The early corporations trailed the clouds of glory of their sovereign origin. Thus the East India Company wore the ermine: late in the eighteenth century English courts dismissed a dispute over its breach of contract as a "political question." . . . It is not surprising to find indications, where "internal affairs" were involved, that a matter of some diplomatic nicety was at stake and even today, when general incorporation laws and nation-wide corporations are of course, courts hasten to add, in taking jurisdiction, that they are not exercising "visitorial powers."[54]

Indeed, well into the twentieth century, the internal affairs doctrine was viewed as a jurisdictional bar—precluding courts from even adjudicating disputes involving foreign corporations' internal affairs—and not merely a choice of law rule.[55] Resting jurisdiction

52. *See infra* Part III.B.1.

53. As late as 1892, one treatise writer on statutory law categorized the law of business and private corporations as public law. E. MERRICK DODD, AMERICAN BUSINESS CORPORATIONS UNTIL 1860, at 15 (1954) (citing 2 FREDERICK J. STIMSON, AMERICAN STATUTE LAW 1 (1892)).

54. Note, *Forum Non Conveniens and the "Internal Affairs" of a Foreign Corporation*, 33 COLUM. L. REV. 492, 494-95 (1933) (citations omitted). "Visitorial powers" were those powers "exercised by the founder of a corporation to make and enforce by-laws and to command faithful performance of duties by officers." *Id.* at 495 n.14.

55. 17 WILLIAM MEADE FLETCHER ET. AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 8425 (perm. ed., rev. vol. 1998); RESTATEMENT OF CONFLICT OF LAWS §§ 196, 197, 199 (1934); Kaplan, *supra* note 31, at 443*; see, e.g.*, N. State Copper & Gold Mining Co. v. Field, 20 A. 1039, 1040 (Md. 1885); Wilkins v. Thorne, 60 Md. 253 (1883); Smith v. Mutual Life Ins. Co., 96 Mass. 336 (1867);

exclusively with the courts of the incorporating state invariably resulted in application of that state's laws to the internal affairs dispute, so the choice of law outcome would be consistent with the modern doctrine.

As a creature of the sovereign, each business corporation was thought to exist only within the territorial borders of the sovereign. Since most businesses were local in character, this territorial notion was unremarkable and caused little controversy before the mid-1800s.[56] This ideology of territorial sovereignty helps explain how the internal affairs doctrine could later emerge as a consensus among states.[57] Only the incorporating state was deemed to possess jurisdiction to decide disputes over its corporation's internal affairs because these disputes implicated the sovereignty of the incorporating state. Courts of other states were unwilling to interfere.[58]

This ideology of sovereignty was also conveniently consistent with legislators' rent seeking interests. Because each grant of corporate privileges was effected by special act, legislators were able to exact tribute from the corporate promoters seeking these special privileges.[59] The ideology of state sovereignty assured that legislative bargains would not be revisited by courts outside the incorporating state.[60]

The next two sections elaborate on the idea of the corporation as a creature of its

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Williston v. Mich. S. & N. Ind. R.R. Co., 95 Mass. 400 (1866); Erickson v. Nesmith, 86 Mass. 233 (1862); Redmond v. Enfield Mfg. Co., 13 Abb. Pr. (n.s.) 332 (N.Y. Sup. Ct. 1872); Howell v. Chicago & Nw. Ry. Co., 51 Barb. 378 (N.Y. Sup. Ct. 1868). This jurisdictional bar also had certain practical underpinnings. Especially with the early cases, courts recognized the difficulty of enforcing a judgment against a foreign corporation, at a time when corporate assets and corporate officers were not typically found outside the incorporating state. As one court noted, "[I]t is a little difficult to imagine how a court in [the District of Columbia] could restrain and direct the action of the corporation at its home office in the city of New York." Clark v. Mut. Reserve Fund Life Ass'n, 14 App. D.C. 154, 178 (1899). *See also* Kan. & E. R.R. Constr. Co. v. Topeka, Salina & W. R.R., 135 Mass. 34 (1883) (finding that court lacked jurisdiction over disputed railroad contract and related stock issuance by Kansas railroad corporation where most significant features of contract were to be performed in Kansas, subject to Kansas law).

56. When businesses eventually began to expand to engage in transactions across state lines, states commonly imposed territorial restrictions on their domestic corporations and forbade foreign corporations from certain businesses and from owning real property in-state. *See infra* Part IV.B.1.

57. It is not too surprising that jurisdictional disputes would not have arisen before the 1860s. Given the quasi-public conception of corporations, their close ties with state legislatures, and the fact that no distinctions were made among municipal, business, and other corporations, it would have been unthinkable during the pre-industrial period for a state's legislature or court to attempt to interfere in the inner workings of the corporate creation of a sister state.

58. Judicial opinions articulating the doctrine regularly noted the sovereign interests of the incorporating state that were at stake. *See infra* notes 160, 326 and accompanying text.

59. The graft and logrolling involved with special charters eventually caused popular resentment of the practice. This was one factor that ultimately led to its demise. *See infra* note 130 and accompanying text.

60. In the early years of the Republic, most states' judges were appointed by the state legislature, and so could be assumed to be sensitive to legislators' interests. Symposium, *The Case for Judicial Appointments*, 33 U. TOL. L. REV. 353, 356-57 (2002). Popular election of state judges became more common only by the mid-1800s. James Andrew Wynn, Jr., *Judging the Judges*, 86 MARQ. L. REV. 753, 764 (2003). With popular elections, of course, judges would feel the same local interest group pressures as legislators did.

Moreover, at least until the turn of the twentieth century, courts faced with internal affairs decisions consistently noted that jurisdiction could not exist absent statutory authority. *See, e.g.*, N. State Copper & Gold Mining Co. v. Field, 20 A. 1039, 1040 (Md. 1885); Smith v. Mut. Life Ins. Co., 96 Mass. 336 (1867); Halsey v. McLean, 94 Mass. 438 (1866); Erickson v. Nesmith, 86 Mass. 233 (1862); Howell v. Chicago & Nw. Ry. Co., 51 Barb. 378 (N.Y. Sup. Ct. 1868); Stafford & Co. v. Am. Mills Co., 12 R.I. 310 (1881).

sovereign. Section A describes the public service functions of the early business corporations and the conception of the corporation as an agency of the state. Section B details the intimate financial and managerial relationships between business corporations and their incorporating states. The final section describes the strict territorial limits of corporate law during this pre-industrial period, the corresponding limits on the powers and very existence of each state's corporate creatures, and each state's territorial regulatory monopoly on its local firms.

A. Agencies of the State

Before 1800, the corporation was not uniquely or even predominantly a tool for commerce. Municipal corporations—towns, districts, and other local government entities—and ecclesiastical, educational, and charitable corporations were far more common than business corporations.[61] The benefits of incorporation were as important to these other types of organizations as they were to businesses: "incorporation allowed a group to make binding rules for its self-government, to function in law as a single person with the right to hold property and to sue and be sued—and so to protect its assets—and to persist after the lifetimes of its founding members."[62] These various corporate entities were distinguishable from voluntary organizations insofar as they enjoyed a delegation of authority from the state that created them. This authority included the power to coerce their membership—i.e., to enforce collective decisions—for the public benefit.

> Only the state had the authority to make laws sanctioned by force. For reasons of its own it could, however, delegate some of its political powers. Associations like the town and its offshoots, granted that privilege, were political entities, little republics in Blackstone's language, or bodies politic. Contemporaries knew such societies as "corporations" and assumed that the general intent, the purpose, of all corporations was for better government, either general or special.[63]

For government entities, the power to govern and to tax were important coercive powers. Business corporations enjoyed the power to retain members' capital and property contributed to the corporation, despite a member's disagreement with the corporation's collective judgment.[64] Before the advent of limited liability, the business corporation also enjoyed the power to enforce unlimited assessments against its members for the firm's capital needs.[65]

While these various types of corporations seem quite different today, no legal

61. Pauline Maier, *The Revolutionary Origins of the American Corporation*, 50 WM. & MARY Q. 51, 53 (1993) (describing pattern of incorporation acts in Massachusetts and other states before 1800).

62. *Id.* at 54. Limited liability for business corporations was an innovation of later vintage. Oscar Handlin & Mary F. Handlin, *Origins of the American Business Corporation*, 5 J. ECON. HIST. 1, 17 (1945); Maier, *supra* note 61, at 55.

63. OSCAR HANDLIN & MARY FLUG HANDLIN, COMMONWEALTH: A STUDY OF THE ROLE OF GOVERNMENT IN THE AMERICAN ECONOMY: MASSACHUSETTS, 1774-1861, at 98 (1947) (internal citations omitted).

64. *Id*.

65. *Id.* at 105; Seligman, *supra* note 31, at 255.

distinctions were drawn among them. In general, the same rules applied to them all.[66] The common law of corporations developed in the context of religious or governmental entities was freely applied to business organizations, and legislative committees for corporate chartering handled petitions from municipal and ecclesiastical organizations as well as banks and manufacturing companies, without distinguishing among them.[67] In particular, no distinctions were made between public and private corporations. *All* corporations, including business corporations, were conceived as public corporations and were expected to serve a public purpose. "[N]o grant was forthcoming without justification in terms of the interests of the state as a whole."[68] Manufacturing companies were meant to promote public goals no less than municipal or charitable corporations, and private benefit to the corporation's promoters was not a consideration.[69] Corporations were generally viewed as "agencies of government . . . for the furtherance of community purposes."[70] Even the business corporation "was conceived as an agency of government, endowed with public attributes, exclusive privileges, and political power, and designed to serve a social function for the state."[71]

Moreover, the vast majority of business corporations chartered before 1800 were engaged in the provision of services traditionally associated with government. Banks, water companies, and transportation companies—for the construction or operation of canals, turnpikes, and bridges—comprised the overwhelming majority of business corporations.[72] While the number of purely private enterprises increased over time, the overall predominance of public service companies probably continued through mid-

66. "The most striking peculiarity found on first examination of the history of the law of business corporations is the fact that different kinds of corporations are treated without distinction, and, with few exceptions, as if the same rules were applicable to all alike." Samuel Williston, *History of the Law of Business Corporations before 1800*, 2 HARV. L. REV. 105 (1888).

67. 2 JOSEPH STANCLIFFE DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 4 (1917). This legislative practice continued in New Jersey until almost 1840. *Id.*

68. HANDLIN & HANDLIN, *supra* note 63, at 78 (internal citations omitted).

69. "That a particular venture would benefit the private estates of individuals seems to have been of no concern—or to have been a positive consideration—as long as the public's welfare was also served." Maier, *supra* note 61, at 56. For example, the Beverly Cotton Manufactory, incorporated in Massachusetts in 1789, was expected to "promot[e] useful manufactures, and particularly such as are carried on with materials of American produce within this Commonwealth," which would advance "the happiness and welfare thereof, by increasing the agriculture and extending the commerce of the country." 1 MASS. SPECIAL LAWS 1780-1805, at 224-26 (Feb. 3, 1789).

70. JAMES NEAL PRIMM, ECONOMIC POLICY IN THE DEVELOPMENT OF A WESTERN STATE: MISSOURI, 1820-1860, at 33 (1954). As late as 1866, Angell and Ames noted in their famous treatise:

> The object in creating a corporation is, in fact, to gain the union, contribution, and assistance of several persons for the successful promotion of some design of general utility . . . . The principle is . . . that the design of a corporation is to provide for some good that is useful to the public. "[A]cts of incorporation . . . ought never to be passed, but in consideration of services to be rendered to the public."

JOSEPH K. ANGELL & SAMUEL AMES, LAW OF PRIVATE CORPORATIONS AGGREGATE § 13 (8th ed. 1866) (1832) (quoting Roane, J. in Currie's Admin. v. Mutual Ins. Soc'y 14 Va. (4 Hen. & M.) 315, 347 (1808) (other citations omitted)).

71. Handlin & Handlin, *supra* note 62, at 22.

72. By 1800, 317 business corporations had been chartered in the U.S., of which 13 were for manufacturing and other miscellaneous business. Banks and insurance companies numbered 62. The rest were transportation companies (207) and providers of local public services (36). DAVIS, *supra* note 67, at 27.

century.[73]

Consistent with their public service purposes and indicative of their quasi-governmental status, business corporations often enjoyed what today might appear to be drastic delegations of governmental authority. Turnpike and canal companies, for example, typically enjoyed eminent domain powers, authority to plan routes, and authority to set toll rates.[74] To encourage private investment in these sometimes risky public service projects, governments often included lucrative monopoly privileges or tax exemptions in the charters.[75] In addition, governments were very generous in bailing out their failing corporate ventures with state lotteries, land grants, and increased tolls.[76]

B. State Involvement with Business Corporations

Given the public service orientation of early business corporations and the fact of their regard as public agencies, state legislatures not surprisingly took an active interest in the formation and subsequent operations of these firms. This relationship between state legislatures and their corporations also helps to explain states' claims to sovereignty over their corporations. In the special chartering process, legislators paid close attention to the particular privileges and powers accorded to each corporation. In addition, states frequently financed the projects of their corporate creations and exercised operational

73. There was some regional variation in the proportions. In Pennsylvania, 2,333 special charters for business corporations were granted between 1790 and 1860. About 1500 of these were for transportation companies; less than 200 were for manufacturing. LOUIS HARTZ, ECONOMIC POLICY AND DEMOCRATIC THOUGHT: PENNSYLVANIA, 1776-1860, at 38 (1948). In New England, the combined number of charters for public utilities and finance consistently outnumbered mining and manufacturing charters before 1831. However, from 1831-1875, charters for mining and manufacturing were the majority. William C. Kessler, *Incorporation in New England: A Statistical Study, 1800-1875*, 8 J. ECON. HIST. 43, 47 (1948).

74. "[I]n every state, . . . the very large powers of eminent domain . . . were transferred wholesale to the private sector." Harry N. Scheiber, *Federalism and the American Economic Order, 1789-1910*, 10 LAW & SOC'Y REV. 57, 95 (1975); *see also* DODD, *supra* note 53, at 44 (citing State v. Hampton, 2 N.H. 22 (1819)) (upholding eminent domain powers granted to turnpike corporation); Chesapeake & O. Canal Co. v. Key, 5 F. Cas. 563 (C.C.D.C. 1829) (No. 2,649) (upholding eminent domain power granted to canal corporation)); Seligman, *supra* note 31, at 255. Railroads also often enjoyed eminent domain powers. *See* Bonaparte v. Camden & A. R. Co., 3 F. Cas. 821 (C.C.D.N.J. 1830) (No. 1,617) (upholding eminent domain powers of railroad corporation).

75. HANDLIN & HANDLIN, *supra* note 63, at 105.

> When neither the [state] government nor any extant body politic was willing or able to execute a desirable but costly function, the state held out to a new corporation inducements in the shape of a promise of profits. Such a promise became credible and attractive if fortified by the grant of a valuable franchise. Tolls, lotteries, or monopolies, and the prestige that came from state sponsorship underwrote the expectation of gain and acted as an enticement for which the members would tax themselves and manage the coveted enterprise efficiently.

Id. As one early example, New Jersey had to offer significant monopoly rights and an extremely generous tax exemption to induce the building of the Camden and Amboy railroad line. Harold W. Stoke, *Economic Influences upon the Corporation Laws of New Jersey*, 38 J. POL. ECON. 551, 555 (1930). "[S]pecial monopolies were granted to the railroads which reserved to them all traffic rights between the points they were authorized to connect. Privilege and exclusion, with a minimum of state regulation and control, were the rule in order to induce capital to invest heavily." *Id.* at 557.

76. HANDLIN & HANDLIN, *supra* note 63, at 112 (describing Massachusetts state bail out of the Beverly Company with a land grant and lottery in 1790); Handlin & Handlin, *supra* note 62, at 16 & n.82 (citing canal and bridge company examples).

oversight.

1. Special Chartering

A grant of corporate privileges was hardly a routine or mechanical administrative process, but was instead a power guarded quite jealously as a matter for the sovereign's discretion. In the English tradition,[77] a grant of corporate privileges was viewed as a sovereign concession, and after the overthrow of English rule, state legislatures succeeded to this sovereign power.[78] "As in the Eighteenth Century negotiations for these contracts were carried on with the crown, so in America they were carried on with the sovereign power of the various states as successors to the crown. In practice this meant the state legislature."[79]

Corporate charters were granted one by one through special acts. By modern standards, corporate charters were quite restrictive and narrowly drawn. Each charter was tailored to the specific business activity contemplated by the corporation's promoters, and the particular privileges and powers of each corporation were required to be explicitly enumerated in its charter.[80] Capitalization of the corporation was typically limited. Corporate activities and the exercise of powers outside of those expressly authorized in the charter were *ultra vires*, subject to challenge by both the state and private interests. The dynamics of the process were those typical of legislation benefiting particular interests. Logrolling was common: individual legislators championed their constituents' charter applications, securing the support of colleagues with the promise of reciprocal support for future acts of incorporation. On occasion, governors vetoed acts of incorporation that offered too much in the way of privileges—which would risk inciting the popular ire—or that triggered opposition from groups threatened by the prospective corporate competitor.[81]

Privileges and powers might vary from one charter to the next, even for corporations engaged in the same type of business, depending on the "vagaries of individual bill drafters . . . for the lawmakers were casual and haphazard about including even clauses the principles of which were universally accepted."[82] In a very real sense, each corporation was uniquely a creation of the legislature that legislated its specific existence and granted its privileges and powers.[83]

77. Blackstone noted that "[t]he king's consent is absolutely necessary to the erection of any corporation." 1 WILLIAM BLACKSTONE, COMMENTARIES 472 (Cavendish 2001) (Oxford, Clarendon Press 1765).

78. DAVIS, *supra* note 67, at 8. Early on, in 1778 the governor of New Jersey attempted unilaterally to grant a charter, but the legislature later voided that charter, declaring itself the sole authority for the exercise of the power of incorporation. The governor agreed, and "the question was settled for good." *Id.* at 9.

79. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 121 (Harcourt, Brace & World, Inc. 1968) (1932).

80. DODD, *supra* note 53.

81. Maier, *supra* note 61, at 67 & n.54. In later years, the governor of New Jersey vetoed several special acts of incorporation in order to deter the use of special charters and to encourage incorporation under New Jersey's general corporation act. JOHN W. CADMAN, JR., THE CORPORATION IN NEW JERSEY: BUSINESS AND POLITICS, 1791-1875, at 159-60 (1949).

82. Handlin & Handlin, *supra* note 62, at 14.

83. Standardization eventually emerged, as states began to adopt standard forms of charters for the principal types of businesses. For example, in 1805, Massachusetts enacted a law specifying the general powers and duties of turnpike corporations. It did the same in 1809 for manufacturing companies. Kessler, *supra* note

2. State Financing and Oversight

States were often actively involved with the financing or operations of their domestic corporations in ways that might seem unimaginable today but that are consistent with the public purposes for which corporations were formed. As part of the price for the corporate privilege and state support, states often asserted themselves as active business partners with their domestic corporations, exercising control through board representation and requiring profit sharing. While in the early years of the Republic, states burdened with Revolutionary War debts were not financially able to offer direct aid,[84] the 1800s saw active state financing for corporations.

Pennsylvania offers a good example. From the early 1800s, the state was an active investor in its banks, turnpike companies, bridge companies, canals, and railroad companies.[85] Having chartered and invested in the Bank of Pennsylvania in 1793, the Bank of Philadelphia in 1803, and the Farmers' and Mechanics' Bank in 1810, the state held bank shares with a par value of $1,990,793 after this last investment.[86] These bank investments turned out to be quite profitable. In 1816, dividends from bank stocks made up two-fifths of Pennsylvania's state revenues.[87] Bank stock dividends constituted the state's "first and principal source of revenue," according to a legislative committee in 1822.[88] By 1835, the state held three-fifths of the stock of the Bank of Pennsylvania.[89]

State-appointed directors were also a typical feature of these corporations. Conflicts between state directors and private directors were also not uncommon, especially during times of economic downturn, when state interests and private interests might diverge.[90] In one instance, dissatisfied with the returns on the state's investments in transportation companies, the Pennsylvania legislature ultimately caused the appointment of state managers in all turnpike companies in which the state was the majority stockholder.[91]

73, at 44. Even then, however, charters were still considered individually and granted individually by legislative acts which relied on the standard forms. Over the course of the nineteenth century, special charters became more and more standardized. DODD, *supra* note 53, at 198 ("It was not long before there developed a tendency toward the adoption of standard forms for most of the principal business types."); JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970, at 136, 146 (1970); LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 169 (1973). Massachusetts had even passed a general incorporation act for aqueducts in 1799, which codified principles embodied in sixteen earlier special acts. Handlin & Handlin, *supra* note 62, at 15.

84. HANDLIN & HANDLIN, *supra* note 63, at 64-67.

85. FRIEDMAN, *supra* note 83, at 169. Hartz offers a useful graph showing the value of Pennsylvania's stock holdings in various types of corporations from 1800-1860. HARTZ, *supra* note 73, at 87.

86. HARTZ, *supra* note 73, at 82-83.

87. *Id.* at 90 n.26.

88. *Id*. at 90.

89. *Id.* at 97. Pennsylvania made investments of similar magnitude in its turnpike companies. These investments grew from $61,937 in 1810 to over $1 million by 1820, and to over $2.3 million by 1843. *Id.* at 83. The amount of state investment in a given company sometimes exceeded the amount of private investment. HARTZ, *supra* note 73, at 83. **WHY NOT JUST *Id.* AGAIN? FT**

90. *See id.* at 96-104.

91. *Id.* at 102. Other states were similarly involved with their corporations. Between 1827 and 1878, the state of New York lent or donated over $10 million for the construction of sixteen railroads. HARRY H. PIERCE, RAILROADS OF NEW YORK, A STUDY OF GOVERNMENT AID 15 (1953). Local government investment in railroads was also common. Maryland controlled ten of the thirty director seats on the board of the Baltimore & Ohio Railroad, while the city of Baltimore controlled eight. FRIEDMAN, *supra* note 83, at 170. New Jersey took

States' delegation of governmental authority to corporations also required particular oversight. For example, exercise by canal companies of eminent domain powers required accompanying review procedures. The charter for Rhode Island's Blackstone Canal Corp. included elaborate provisions for external supervision. As the corporation identified the route of the canal, it was required to file reports with the court of common pleas describing the route and the names of affected landowners, who were required to be given notice of the taking of their land.[92] Commissioners were to be appointed by the court to estimate the damages sustained by these affected landowners. The charter also described dispute resolution mechanisms.[93] Finally, as earlier described, states often stepped in to offer assistance when their business corporations hit upon hard times.[94]

The notion that corporations were creatures of the state, then, was more than theoretical fancy. States were often intimately involved with their corporations' finances and operations, as well as their formation. The public service nature of business corporations' activities, together with states' active involvement in overseeing and investing in their domestic corporations, help explain the ideology of states' dominion over their corporations.

C. Territorial Monopoly in Corporation Law

Consistent with the notion of corporations as agencies of their incorporating states, and with the delegation of public powers and functions that corporations enjoyed, it was generally understood that a corporation's legal standing reached only to the borders of the incorporating state.[95] Corporate law had only a territorial effect,[96] and a corporation existed only within the borders of the sovereign that created it.[97] Assuming the

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preferred stock in exchange for exclusive transport franchises. *Id.* From 1832 through the Civil War years, the lion's share of New Jersey's general fund revenues came from dividends on its railroad stocks. *See* GRANDY, *supra* note 32, at 24 (charting percentage of state fund receipts from railroad revenues). These dividends rarely made up less than half the general fund in any given year, and for a fifteen-year period, railroad dividends accounted for over ninety percent of general revenues, allowing abolition of the state property tax during that period. *See id.* at 23.

92. Farnum v. Blackstone Canal Corp., 8 F. Cas. 1059, 1062 (C.C.D.R.I. 1830).

93. *Id.* at 1062-63.

94. *See supra* note 76 and accompanying text.

95. Moreover, corporate charters often granted special privileges that could only be enjoyed within the incorporating state. The famous Society for Establishing Useful Manufactures (S.U.M.), for example, was incorporated in New Jersey. Its charter exempted it from taxes for ten years and exempted its employees from poll and occupation taxes. DAVIS, *supra* note 67, vol. 1 at 384. S.U.M. was also granted the power of eminent domain to cut canals and collect tolls, as well as authority to form a municipal corporation and to raise capital by conducting a lottery. *Id.* at 385-86. S.U.M. was unusual as to the breadth of activities that were authorized in its charter. *Id.* at 379. However, the various powers granted were not in themselves unusual. The Camden and Amboy railroad company enjoyed monopoly rights and tax exemptions. *See supra* note 75.

96. *See* Blackstone Mfg. Co. v. Blackstone, 13 Gray 488, 489 (Mass. 1859).

97. Bank of Augusta v. Earle, 38 U.S. 519, 588 (1839).

> It is very true that a corporation can have no legal existence out of the boundaries of the sovereignty by which it is created. It exists only in contemplation of law, and by force of the law; and where that law ceases to operate, and is no longer obligatory, the corporation can have no existence. It must dwell in the place of its creation, and cannot migrate to another sovereignty.

Id. at 588.

corporation was so empowered by its charter, transactions and activity outside the home state were permitted only at the sufferance of the host state, and states had the power to bar foreign corporations from operating locally.[98]

In its famous decision in *Bank of Augusta v. Earle*,[99] the U.S. Supreme Court held that corporations were not entitled to the Constitutional protections of the privileges and immunities clause.[100] To find otherwise would lead to the then unthinkable result that corporations chartered in one state could freely carry on operations in another, regardless of the laws of the host state.

> [I]t would deprive every state of all control over the extent of corporate franchises proper to be granted in the state; and corporations would be chartered in one, to carry on their operations in another. It is impossible upon any sound principle to give such a construction to the article in question.[101]

In this pre-industrial period, the territorial nature of states' dominion over domestic corporations was consistent with corporations' own limited geographical reach. Technological limitations—in transportation, communication, and energy—meant that firms had primarily local operations and transacted primarily in local markets. In 1830, for example, the United States had only *twenty-three* miles of railroad track.[102] With only humans, animals, wind, and water as energy sources, only low volumes of production and exchange were possible, such that "[b]usiness enterprises remained small and personally managed."[103] At mid-century, it was quite uncommon for corporations of one state to own fixed or real property in another.[104] The partnership was the most common business form, and the actors within a business were ordinarily close family members.[105] Each firm had an identifiable "center of gravity" in one state. If a firm wished to incorporate, it did so in its home state.[106] Corporations with explicit interstate ambitions—for the

98. The *Bank of Augusta* court specifically noted:

> Every power . . . of the description of which we are speaking, which a corporation exercises in another state, depends for its validity upon the laws of the sovereignty in which it is exercised; and a corporation can make no valid contract without their sanction, express or implied.

Id. at 589. While the court ultimately upheld the enforceability of the interstate contracts at issue, the holding was based on the presumption—given the lack of any state law to the contrary—that the host state Alabama permitted foreign corporations to contract locally. Principles of comity among states justified such a presumption. *Id.* at 589.

99. 38 U.S. 519 (1839).

100. U.S. CONST. art. IV, § 2, cl. 1.

101. *Bank of Augusta*, 38 U.S. at 586-87. Thirty years later, the Supreme Court affirmed the same basic idea. *See infra* note 181 and accompanying text; *see also* Henry N. Butler, *Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. LEGAL STUD. 129, 155 (1985) ("As late as the 1860s, the status of operating a corporation in a foreign jurisdiction was uncertain.").

102. HISTORICAL STATISTICS OF THE UNITED STATES, 1789-1945, at 200 (1949). By 1860, that number had leapt to 30,626 miles, and by 1880, there were 93,262 miles of track. *Id.*

103. ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 48 (1977).

104. In 1859, the Supreme Judicial Court of Massachusetts noted "the very few exceptional instances of real and personal property held and used in this state, by a foreign corporation." Blackstone Mfg. Co. v. Blackstone, 13 Gray 488, 491 (Mass. 1859); *see also* FRIEDMAN, *supra* note 83, at 173 & n.13.

105. CHANDLER, *supra* note 103, at 50.

106. DODD, *supra* note 53, at 151 (noting that in the era before 1860, "most corporations were organized

construction and operation of canals or bridges, for example—obtained multiple charters from the legislatures of the states in which they sought to do business.[107]

In this context, each state enjoyed something of a territorial regulatory monopoly over its local firms—not only for corporate law, but for economic regulation generally. Only with great difficulty could firms physically exit their home jurisdictions, since their product and labor markets, and to a great extent their capital markets, were at home. Until the approach of industrialization, conflicts among states over corporate law would have been rare. Given the coincidence of a firm's state of incorporation and the situs of its operations, the idea that each state would enjoy plenary authority over the internal affairs of its domestic corporations would not have been controversial, consistent as it was with each state's general territorial powers.

With this plenary authority, legislatures could extract rents from geographically captive businesses in terms of fees and other exactions. Later, as technological innovation enabled firms' activities to cross state lines, legislatures would initially attempt to reinforce firms' territorial limits through legal mandate. They would enact rules both to keep domestic corporations in-state and some foreign corporations out. Disputes concerning foreign corporations arose in due course, and the deference to the state of incorporation embodied in the internal affairs doctrine was consistent with the notions of territorial sovereignty that developed in the earlier pre-industrial period. A state's assertion of its own local law—or its legislative or judicial authority—to govern the internal affairs of a foreign corporation would have seemed quite intrusive. It would effectively have exercised authority over another state's legislature. Courts' express renunciation of visitorial powers over foreign corporations was simply a recognition that exercise of such powers would be an affront to a sister state. Even with industrialization, discussed in the next Part, the territorial notion of corporate law remained resilient until the great merger movement in the 1890s.

IV. INDUSTRIALIZATION, INTERSTATE FIRMS, AND ARTICULATION OF THE INTERNAL AFFAIRS DOCTRINE

With industrialization, firms' activities began to cross state lines beginning in the mid-nineteenth century. Interstate markets emerged, following dramatic advances in transportation, communication, and energy production. The Supreme Court's Commerce Clause jurisprudence also facilitated market integration. Interstate markets led to the rise of interstate firms. However, corporate law was still largely territorial at mid-century: firms ordinarily incorporated in the state where their organizers resided and where their major operations were located. Corporations and legislatures expected—and legislatures sometimes mandated—that corporations would have significant operations in the incorporating state, that officers and directors would be residents of that state, and that

under the law of the organizers' home state").

107. *See, e.g.*, Farnum v. Blackstone Canal Corp., 8 F. Cas. 1059, 1062 (C.C.D.R.I. 1830) (No. 4,675) (involving companion Massachusetts and Rhode Island corporations formed to build canal from Worcester to Providence); *see also* DAVIS, *supra* note 67, at 30 (enumerating dual-chartered corporations before 1800); GERARD CARL HENDERSON, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW 30-31 (1918) (discussing formation of Potomac Company, incorporated in both Maryland and Virginia, to render Potomac River navigable).

shareholders' and directors' meetings would be held in the state.[108] Firms therefore ordinarily maintained significant tangible identification with their incorporating state.[109]

With the emergence of interstate product markets and with a changing industrial organization, however, firms became geographically more mobile at the margin. They enjoyed some latitude to shop for favorable business conditions, including attractive corporate law, simply by moving operations to a neighboring state.[110] Legislatures saw their once-plenary regulatory authority over local economic activity being contested.[111] They therefore felt some pressure to liberalize their corporate laws, including the relaxation of territorial restrictions, in order to maintain local employment and the industrial tax base. This sort of charter competition I call "weak-form" competition—states' adjustments to territorial corporate law as part of a general effort to attract capital and labor by offering an hospitable business environment.[112] This was the primary form of jurisdictional competition over corporate law until the 1890s, when "strong-form" law-as-a-product competition ensued.[113]

The emergence of interstate firms led to disputes over corporate internal affairs that were brought in courts outside the incorporating state. These suits typically involved shareholders suing in their home states to enforce rights against foreign corporations in which they had invested. During this period, courts first enunciated the internal affairs doctrine, reflecting pre-industrial notions of states' territorial sovereignty over their domestic corporations.

In this Part, I describe the economic, political, and legal contexts in which the doctrine emerged. I focus on the roughly forty-year period from the mid-nineteenth century up until about 1890, a transitional period during which the legal past commingled with the economic future. I also detail the judicial development of the internal affairs

108. In complementary fashion, corporations with no economic ties to the state of incorporation—"tramp" corporations—often found that host states would refuse to recognize their corporate status. *See infra* notes 333-334 and accompanying text.

109. While this territorial nature of corporate law would weaken as industrialization progressed through the second half of the century, maintenance of some territorial ties between the corporation and its incorporating state would remain the norm until the 1890s when charter competition began in earnest.

110. *See infra* Part IV.B.1.

111. Especially before the Civil War, states enjoyed considerable regulatory power to control economic activity within their borders. States had always competed for economic development in a sort of "rivalistic state mercantilism." Scheiber, *supra* note 74, at 71-72. They shaped their regulation to attract capital and labor from neighboring states.

112. This fear of competitive disadvantage in attracting firms competing in newly expanded interstate markets was not a problem unique to corporate law. States felt similar pressures with regard to social legislation. *See* William Graebner, *Federalism in the Progressive Era: A Structural Interpretation of Reform*, 64 J. AM. HIST. 331 (1977).

113. With "strong-form" competition, firms could choose their corporate law independent of their location, the residence of their organizers, or other territorial considerations. *See infra* Part V.

Raising revenues directly through the sale of corporate charters was an innovation that occurred only in the 1890s with New Jersey's implementation of its "chartermongering" strategy. *See* Christopher Grandy, *New Jersey Corporate Chartermongering, 1875-1929*, 49 J. ECON. HIST. 677, 680-81 (1989). Before 1888-1890, even New Jersey's corporate law liberalization was done primarily with local firms in mind—firms with operations located primarily in-state. *See infra* note 155 and accompanying text. A special Massachusetts legislative committee report in 1903 noted that "[u]ntil within the past ten years the practice of foreign incorporation was not general." MASSACHUSETTS COMMITTEE ON CORPORATION LAWS, REPORT OF THE COMMITTEE ON CORPORATION LAWS 18 (1903) [hereinafter MASSACHUSETTS REPORT].

doctrine and note its consonance with legislators' private interests in this period before modern charter competition. The discussion of this period concludes by correcting a misconception about the significance of Supreme Court Commerce Clause decisions of the period for modern corporate charter competition and the internal affairs doctrine. Counter to what some scholars have suggested, I show that these decisions did not lead inexorably to strong-form charter competition or universal respect for firms' choice of corporate law. Instead, it was not until the Great Merger Movement of the 1890s that political and economic conditions were right for charter competition.

A. National Product Markets and Interstate Firms

By mid-century, the United States was well on the way to industrialization. Enormous advances occurred in industrial technology, energy, transportation and communication. In 1830, it took three weeks to go from New York to Chicago by rail. By 1857, the same trip could be made in three days.[114] Railroad integration also improved the efficiency of rail transport. In 1849, freight from Philadelphia to Chicago required at least nine transshipments over as many weeks. Ten years later, the same shipment took three days and only one shipment.[115] In 1869, the first transcontinental railroad was completed by the joining of the rails of the Union Pacific and Central Pacific railroads at Promontory Summit in Utah. The advent of the telegraph and its widespread availability also played a crucial role in creating interstate product and capital markets.[116] From 1825 to the mid-1840s, coal output soared from almost nothing to two million tons per year.[117] Abundant coal and the increasing sophistication of coal-using technologies enabled increased output in metalworking industries. This led to large-scale fabrication of interchangeable metal parts, which, along with this new industrial energy source, paved the way for mass production.

The Supreme Court decided important Commerce Clause cases in the mid-late 1800s that facilitated the rise of interstate markets by curbing states' protectionist impulses in the face of industrialization. One important set of cases ended the commonplace of discriminatory taxation on out-of-state products, which was apparently conventional practice before 1876.[118] Beginning in that year with the decision in *Welton v. Missouri*,[119] the Court used the Commerce Clause to strike down these discriminatory tax burdens.[120] The Court went even further in *Robbins v. Shelby County Taxing*

114. CHANDLER, *supra* note 103, at 83-87 (describing railroad boom of 1840s and technological advances resulting in increased passenger and cargo carrying capacity).

115. *Id.* at 122.

116. *See* Richard B. Du Boff, *Business Demand and the Development of the Telegraph in the United States, 1844-1860*, 54 BUS. HIST. REV. 459, 461 (1980) (noting significance of "distance-shrinking" potential of early telegraph and its critical role in "forging extralocal and interregional links among merchants, bankers, brokers, and shippers").

117. CHANDLER, *supra* note 103, at 76.

118. Charles W. McCurdy, *American Law and the Marketing Structure of the Large Corporation, 1875-1890*, 38 J. ECON. HIST. 631, 635 (1978).

119. Welton v. Missouri, 91 U.S. 275, 282 (1876).

120. *Welton* involved a Missouri law requiring merchandising agents of foreign corporations to pay a licensing fee for the privilege of selling out-of-state goods in Missouri. The plaintiff, an agent for the Singer Sewing Machine Company, challenged the law as a restraint on interstate commerce. Recognizing that the licensing fee was essentially a tax on the goods themselves, the court invalidated the law to avoid a trade war

District,[121] striking down a Tennessee license tax on drummers for out-of-state manufacturers, and holding explicitly that "[i]nterstate commerce cannot be taxed at all."[122]

The combination of technological innovation and this rule of nondiscrimination against out-of-state products facilitated the emergence of interstate product markets for manufacturers and distributors. Firms' customers and suppliers were now scattered across numerous states, and with these new and larger markets, firms grew to meet this greater demand.[123] Improved transportation and communication enabled parties to transact and manage from afar. "The almost simultaneous availability of an abundant new form of energy and revolutionary new means of transportation and communication led to the rise of the modern business enterprise in American commerce and industry."[124]

B. Interjurisdictional Pressures on Territorial Corporate Law: Weak-Form Charter Competition

This section describes the evolving corporate law context in which courts first articulated the internal affairs doctrine. With industrialization and interstate firms, the legal demands of those firms grew. What were initially conventional corporate law restrictions—on capitalization, on permissible business activities and their geographical scope—became a hindrance on the growth and expansion necessary for firms to survive. States had always competed with one another for economic development. Now with the changing needs of business, state legislatures responded by loosening some of these corporate law constraints. However, they did not abolish all of them. Instead, they retained the basic idea of limiting corporate size and scope through corporate law. And they continued to demand that their corporations maintain economic ties to their incorporating states.

1. States' Struggle to Maintain Territorial Monopoly

In the early years of industrialization, as corporations' activities had initially begun to cross state lines, states responded by mandating in-state ties for their domestic corporations and discriminating against foreign corporations attempting to do business locally. For domestic corporations, it was assumed or required that operations "would be confined within the chartering state."[125] For a manufacturing company, the charter

among the states. *Id.* at 281-82.

121. Robbins v. Shelby County Taxing Dist., 120 U.S. 489 (1886).

122. *Id.* at 498. The contours of this basic idea were left to be worked out over the ensuing twenty years. *See* HENDERSON, *supra* note 107, at 119-31.

123. Integrated markets also created scale economies that provided some of the impetus to the Great Merger Movement that began in the last decade of the nineteenth century. It was then that charter competition began in earnest. *See infra* Part V.

124. CHANDLER, *supra* note 103, at 78.

125. Butler, *supra* note 101, at 142; Edward Q. Keasbey, *New Jersey and the Great Corporations*, 13 HARV. L. REV. 198, 204 (1899) ("It was assumed in the legislation that the activities of New Jersey corporations would be confined within the state."); Stoke, *supra* note 75, at 562. In his statistical study of New England incorporations, Kessler notes that only in the period 1863-1875 were a number of charters granted for out of state mining and petroleum activity. Kessler, *supra* note 73, at 60.

typically even specified the particular town where the company would operate.[126] Corporations were required to hold their director's meetings and shareholder meetings in-state.[127] Certain corporate officers and/or a minimum number of the corporation's directors were typically required to be state residents, and the corporate books and records were required to be located in-state.[128] With these restrictions, state legislatures attempted to cement their domestic corporations' dependence on their legislative grace.

As for foreign corporations, discrimination against foreign banking and insurance companies was common, as were prohibitions against foreign corporations' ownership of real property.[129]

With interstate firms becoming increasingly more common, however, states felt pressure to ease some restrictions. Interstate firms with multistate markets enjoyed some freedom to migrate. With dispersed customers and suppliers, all reachable through the new technologies, manufacturers and distributors could move their operations without necessarily reducing access to their markets. This increased mobility meant that even with strictly territorial corporate law, firms could move to more favorable jurisdictions.

With this exit option for firms, state legislatures' territorial monopolies weakened. Corporate law remained territorial, in the sense that a firm was expected to maintain substantive ties to its incorporating state. Most corporations operated solely or predominantly within their incorporating states. However, firms' geographical mobility enabled their flight from a jurisdiction with unattractive corporate law—or tax law or labor law, for that matter. A firm's physical exit meant not only a lost corporate charter, but more importantly also lost jobs and tax revenues. State legislatures began to feel some pressure to be responsive to the demands of both local capital and capital that might be enticed into their states.

2. General Incorporation and the Regulation of Local Industrial Organization

At the same time that the demand for corporate law was changing, Jacksonian populism led states to adopt general incorporation statutes, a trend that continued through most of the nineteenth century.[130] These general incorporation statutes co-existed with

126. DODD, *supra* note 53, at 400 n.29 ("[M]anufacturing company charters of the period usually required that the enterprise be located not only in the state but in a particular town."). Even absent formal legal prohibition, "the operation of a factory or mine by a foreign corporation would probably have been generally regarded as so contrary to the *mores* of the times as to be an unwise business practice." *Id.* at 325.

127. "All votes and proceedings of persons professing to act in the capacity of the corporations, when assembled beyond the bounds of the State granting the charter of the corporation, are wholly void." JOSEPH K. ANGELL & SAMUEL AMES, LAW OF PRIVATE CORPORATIONS AGGREGATE § 498 (8th ed. 1866) (1832)*; see also* Keasbey, *supra* note 125, at 204 (describing New Jersey corporation act of 1849).

128. *See* Stoke, *supra* note 75, at 561-62 (describing New Jersey's general corporation law of 1849). Even toward the end of the nineteenth century, states revoked the charters of their noncompliant corporations.

129. SEYMOUR D. THOMPSON, CORPORATIONS § 7913 (1896); *cf.* Richardson v. Swift, 12 Del. 137, 151 (1885) (describing special act of Delaware legislature authorizing Connecticut corporation to own real property in Delaware).

130. *See* RALPH NADER ET AL., TAMING THE GIANT CORPORATION 37 (1976). The practice of special incorporation was condemned for the graft and favoritism it spawned, as promoters were forced to lobby for special legislation granting them the powers and privileges of the corporate form. *Id.*; CADMAN, *supra* note 81, at 163; WILLIAM W. COOK, THE CORPORATION PROBLEM 110 (1891). In some states, the sheer volume of special chartering activities also crowded out other work of the legislature, leaving little time or attention for

the earlier practice of special incorporation for several decades.[131] Initially, general incorporation privileges were quite limited by modern standards. Statutes were restrictive, rather than enabling. Besides territorial restrictions of the sort earlier described,[132] limits on capitalization and debt, corporate longevity, and permissible business activities were also typical. Statutes distinguished different types of business activities, setting different restrictions for different businesses. The detailed distinctions and restrictions suggest that states relied on their general incorporation statutes to regulate their local industrial organization.[133]

These careful delineations and restrictions in the general laws were understandable given the general fear, prevalent during this period, of large aggregations of capital and corporate power, as well as political demands for economic protection. Judge Brandeis captured this sense in his classic dissent in *Liggett Co. v. Lee*. Fear was widespread:

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public legislation. *Id.* at 161-62; FRIEDMAN, *supra* note 83, at 172. As one example, in 1870, the New Jersey Senate formed two standing committees on corporations, in addition to its regular committee on corporations, to handle the volume of special charter applications. One standing committee handled railroad, canal, and turnpike charters, while the other handled banks and insurance companies. CADMAN, *supra* note 81, at 162 n.37. General incorporation statutes were meant to eliminate these problems and to make corporate privileges generally accessible.

By 1850, general incorporation statutes permitting incorporation for a limited business purpose were common. Statutes allowing incorporation for every lawful business became common after 1875. Liggett Co. v. Lee, 288 U.S. 517, 555 & n.28 (1933) (Brandeis, J., dissenting).

131. Moreover, the process of special incorporation also became more standardized over time, as legislatures either adopted standard forms or passed laws standardizing the general terms of special charters. *See, e.g.*, MASSACHUSETTS REPORT, *supra* note 113, at 16-17 (describing progression of legislation standardizing certain aspects of special charters prior to enactment of general incorporation statute in 1851); *see also* HURST, *supra* note 83, at 146 (noting standard patterns in terms of special charters); DODD, *supra* note 53, at 198 ("[I]t was not long before there developed a tendency toward the adoption of standard forms for most of the principal types of business corporations."); Kessler, *supra* note 73, at 44 (describing cross-reference in special charters to laws specifying general powers and duties of corporations).

132. *See supra* notes 125-129 and accompanying text.

133. For example, in 1811 New York offered general incorporation for certain specified business purposes: manufacturing woolen, cotton, or linen goods; making glass; making, from ore, bar iron, anchors, mill irons, steel, nail rods, hoop iron, ironmongery, sheet lead, shot, white lead, and red lead. 1811 N.Y. Laws, ch. 67. Capital was limited to $100,000, the life of the corporation was limited to 20 years, and shareholders were liable if corporate assets were insufficient to pay creditors upon dissolution. *Id.* Legislatures began to offer corporate limited liability for particular enterprises and types of enterprises early in the nineteenth century. However, as for general corporate limited liability, legislatures in many states struggled with the question through the first half of the nineteenth century. The issue remained controversial in some states until well into the second half of the nineteenth century. *See* DODD, *supra* note 53, chs. V, VI. Later in 1817, general incorporation was made available for the manufacture of certain leather, but capitalization was limited to $60,000. *Liggett*, 288 U.S. at 551 n.6 (citing Act of April 14, 1817, ch. 223). In 1821, incorporation for the manufacture of salt was made generally available, with capital limited to $50,000. *Id.* (citing 1821 Laws of N.Y., ch. 231, § 19). An 1852 enactment offered general incorporation for firms engaged in ocean navigation, with capital not to exceed $2,000,000. This limit was progressively raised and then lowered over the years. *See id.* Similar patterns of distinctions and limitations were followed in other states. *See id.* at 550-56. As another example, a Massachusetts act in 1870 permitted capitalization of $500,000 for mining and manufacturing corporations, but only $5,000 for the propagation of herring and alewives. *See id.* at 551 n.8 (citing 1870 Mass. Acts & Res., p. 154). Even after the great merger movement, some states retained numerous specific incorporation provisions with different restrictions and limitations for different types of businesses. As late as 1903, Texas and Tennessee each made special provisions for about sixty different types of corporations, and Indiana had over fifty classes. MASSACHUSETTS REPORT, *supra* note 113, at 160.

> Fear of encroachment upon the liberties and opportunities of the individual. Fear of the subjection of labor to capital. Fear of monopoly. Fear that the absorption of capital by corporations, and their perpetual life, might bring evils similar to those which attended mortmain. There was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations.[134]

The enactment of general incorporation laws, according to Brandeis, "[did] not signify that the apprehension of corporate domination had been overcome."[135] Instead, the need for business expansion created an "irresistible demand for more charters."[136] While attempting to respond to this demand, the general laws also "embodied severe restrictions upon size and upon the scope of corporate activity, [which] were, in part, an expression of the desire for equality of opportunity."[137]

Because of the numerous limitations on corporate finance and operations contained in early general incorporation laws, for a time special incorporation remained attractive as a path to securing privileges unavailable under general laws,[138] including the privilege to do some business outside the incorporating state.[139] In New Jersey, before their abolition in 1875, special charters with liberal provisions not available under the general law were regularly used as a device to induce the investment of out-of-state capital.[140] In

134. *Liggett*, 288 U.S. at 548-49 (footnote omitted).

135. *Id.* at 549.

136. *Id.*

137. *Id.*

138. For example, corporations were generally forbidden from holding stock in other corporations. However, as early as the 1850s, state legislatures gave specific permission to particular corporations to do so by way of special chartering. FRIEDMAN, *supra* note 83, at 454-55. In Wisconsin between 1848 and 1871, almost ten times as many special charters were issued as general charters. GEORGE J. KUEHNL, THE WISCONSIN BUSINESS CORPORATION 143 (1959). Similarly, in New England between 1844 and 1862, the number of special charters granted outnumbered those issued under general statutes by more than 2.5 times. *See* Kessler, *supra* note 73, at 57. Butler has suggested a price discrimination explanation for the dual incorporation system. States offered a standardized product with low production costs—the general charter—but also made special privileges available to those willing to pay more for the customized product—the special charter. Butler, *supra* note 101, at 148-49.

Under this dual system of incorporation, courts did not distinguish general charters from special charters in their reluctance to exercise jurisdiction over foreign corporations. *See, e.g.*, Halsey v. McLean, 94 Mass. 438 (1866) (holding that, in case involving corporation formed under New York's general incorporation law, personal liability of stockholder depended on statutory system of another state, and therefore execution could not be obtained in a Massachusetts court).

139. *See* Butler, *supra* note 101, at 151 & n.87; CADMAN, *supra* note 81, at 168.

140.

> In individual incorporation acts passed for the benefit of out-of-state petitioners, New Jersey was willing to give terms more attractive to businessmen than any that would have been approved in general laws in the middle years of the nineteenth century. Since the New York constitution of 1846 made it difficult for promoters to obtain special acts of incorporation in that state, New Jersey maintained a competitive advantage in the field of chartering by retaining its system of special acts of incorporation. As early as 1847, the opportunity thus offered to outbid New York in the matter of business charters had been recognized.

CADMAN, *supra* note 81, at 174-75. For example, a number of special charters gave permission for stockholders' and directors' meetings to be held in New York or Philadelphia, where the promoters and investors resided. *Id.* at 177. Similarly, New York and Philadelphia investors procured a large number of special

New England, special chartering was the "predominant mode of securing corporate privileges" for the first three-quarters of the nineteenth century.[141] Beginning in 1845, states adopted constitutional amendments prohibiting special incorporation.[142]

With the demise of special chartering, state legislatures were forced to rely on their general laws to offer corporate privileges broad enough to meet the demand for incorporations that could no longer be addressed through special enactments. So legislatures dismantled some restrictions in their general laws.[143] For example, in 1866, New York expanded the permissible purposes for general incorporation to "any lawful purpose."[144] In 1875, the limit on corporate capital was raised to $2 million.[145] It was raised to $5 million in 1881.[146] Massachusetts progressively liberalized the scope of activity for which general incorporation was available. Its first general law in 1851 permitted incorporation for "any kind of manufacturing, mechanical, mining or quarrying business," with capital limited to $200,000.[147] The scope of permissible activities and capital limits were gradually increased through successive revisions,[148] and general incorporation for any lawful purpose was offered in 1874.[149] Beginning in 1862, Maine offered general incorporation with limited liability to manufacturing companies, but with capitalization limited to $50,000.[150] In 1876, the number was raised to $500,000;[151] in 1883, it was raised to $2,000,000.[152]

3. Continuing Territoriality and Weak-Form Charter Competition

In the face of private demand for more liberal corporate law, weak-form charter competition emerged. Despite liberalization, domestic corporations still were expected to maintain significant economic ties with their incorporating states.[153] These territorial

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charters for mining and oil companies that permitted the ownership of real estate in any state or territory.

141. Kessler, *supra* note 73, at 43.

142. *See* CADMAN, *supra* note 81, at 183-86; Butler, *supra* note 101, at 152-53. By 1875, nineteen of the thirty-seven states had adopted absolute constitutional prohibitions on special incorporation, while three more had adopted qualified prohibitions, and one mandated general incorporation laws without abolishing special charters. *See* Butler, *supra* note 101, at 152-53.

143. *See* GRANDY, *supra* note 32, at 41 (noting relative liberality of New Jersey's first General Incorporation Act of 1875, enacted in response to state constitutional amendment abolishing special charters).

144. HARRY G. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 17 & n.12 (1961).

145. N.Y. Gen'l Bus. Corp. Act of 1875, ch. 611, § 11.

146. N.Y. Gen'l Bus. Corp. Act of 1875, ch. 295.

147. Mass. Act of May 15, 1851, ch. 133, *quoted in Liggett*, 288 U.S. at 551 n.8.

148. *See Liggett*, 288 U.S. at 551-52 & nn.8-10.

149. Mass. Act of April 14, 1874, ch. 165, § 1, *quoted in Liggett*, 288 U.S. at 555 n.28.

150. MAINE ACTS AND RESOLVES, ch. 152, p. 118 (1862).

151. MAINE ACTS AND RESOLVES, ch. 65, § 2, p. 51 (1876) (increasing capitalization to $500,000).

152. MAINE ACTS AND RESOLVES, ch. 116, § 1, p. 95 (1883) (increasing capitalization to $2,000,000). In the face of the great merger movement, in 1891 the number was raised dramatically to $10,000,000. MAINE ACTS AND RESOLVES, ch. 99, § 1, p. 88 (1891). Finally in 1901, the limitation was removed entirely. MAINE ACTS AND RESOLVES, ch. 229, § 8, p. 242 (1901).

153. Even after general incorporation became widespread, many states' general incorporation statutes required a majority of incorporators, directors, or both to be residents of the incorporating state. *E.g.*, CAL. CIV. CODE § 285 (1885); CONN. GEN. STAT. § 1944 (1888); ILL. REV. STAT. ch. 114, § 11 (1891); ME. REV. STAT. chs. 47, 51, pp. 412, 467 (1883); MD. GEN. LAWS p. 299 (1888); OHIO REV. STAT. § 3236 (1886); PA. DIG. tit.

restrictions meant that firms could not freely shop for corporate law across all states. Depending on the details of each state's territorial requirements, organizers could pursue charters only from states where they might wish to locate the firm's principal place of business or significant operations, or where they could recruit additional local organizers. For most businesses, especially established ones, this typically meant a state neighboring the organizers' home state.

Given these conditions, corporate law was not yet viewed by states as a product in itself, but as a marketing device to attract capital and labor. Corporate charters were not intended to raise state revenues directly, and they were not priced to do so.[154] Instead, liberal tax and corporation laws were part of a more general program to create an attractive environment for doing business in-state. Even with New Jersey, the original charter mongering state, before 1888 its corporate law reforms assumed that its corporations would have some operations in the state.[155] As early as 1845, New Jersey's

Corporations, § 63 (P.L. 1868, p. 80, § 1) (Purdon's 13th ed. 1905); *see also* WIS. STAT. ch. 85, § 1750 (1908) (chief managing officer or superintendent must reside in state, except in case of interstate railroad). Some explicitly restricted the corporation to doing in-state business; *see* Kessler, *supra* note 73, at 48-49 (noting such a limitation in Vermont's general incorporation law of 1851); Keasbey, *supra* note 125, at 204 (noting that before 1865, New Jersey's general corporation law required that business be carried on in-state, and that stockholders' and directors' meeting be conducted in-state); or required the corporation to maintain its headquarters and books and record in-state. States sometimes revoked the charters of their noncompliant corporations. *See, e.g.*, State v. Milwaukee, Lake Shore & W. Rwy Co., 45 Wis. 579 (1878) (finding that failure of common law duty to keep principal office, corporate records, and residence of principal officers in-state may justify forfeiture of corporate charter); State v. Topeka Water Co., 52 P. 422 (Kan. 1898) (affirming forfeiture of Kansas charter for corporation's failure to keep a principal place of business, books and records, and treasurer in-state as required by Kansas law); State v. Park & Nelson Lumber Co., 58 Minn. 330 (1894) (vacating Minnesota charter because of noncompliance with state laws requiring in-state residence for secretary and treasurer, as well as that corporation's principal place of business and books and records remain in-state). An 1865 enactment gave express permission to New Jersey corporations to carry on part of their business outside the state and to own property outside the state, but only to the extent "necessary for and consistent with the purposes of the company," and further provided that a majority of "the persons associated together in the organization of such company" were citizens and residents of New Jersey. Stoke, *supra* note 75, at 562 (quoting 1866 Laws of New Jersey 344, 356).

154. In New Jersey at the time, "[t]he state government did not benefit directly by way of increased revenues on account of . . . out-of-state enterprises." CADMAN, *supra* note 81, at 180. Christopher Grandy describes the almost serendipitous route by which New Jersey in 1884 arrived at the notion of taxing corporations generally according to their authorized capital. Only four years later did New Jersey begin to implement an active program to sell charters. *See infra* note 227 and accompanying text.

155. GRANDY, *supra* note 32, at 40-41. "Limitations of corporate life, capital stock requirements, property taxation, etc., make sense only if the firm engages in economic activity within state borders." *Id.* at 41. A similar assumption likely underlay the provision in New Jersey's 1875 General Corporation Act requiring firms incorporated under the Act to pay real and personal property taxes at the same rate as individuals. *Id.* at 42 (citing General Corporation Act § 105 (1875)).

As early as the 1860s, New Jersey did apparently offer some special charters for projects that would operate wholly outside the state, but the practice was controversial. CADMAN, *supra* note 81, at 178-80. One editorial criticized the legislature:

> It is certainly derogatory to the character of our legislators to have an impression exist abroad that it requires but little management, in connection with a judicious hospitality, to secure the passage of bills through our Legislature. That such an impression does exist is apparent from the attempt made by citizens and residents of other States, from time to time, to secure the passage of acts of incorporation, and other measures for private emolument, which their own States either utterly refuse to grant, or do so only after proper examination and criticism . . . . [I]ncorporations . . . with

success in offering liberal charters to attract out-of-state capital was noted. A pamphlet published that year in South Carolina, presumably to goad the South Carolina legislature into offering competitive charters, recounted:

> A very large manufacturing establishment has been recently put in operation at Gloucester-point in New-Jersey, three miles below Philadelphia. The owners are Philadelphians, who made choice of that location, because a more liberal charter could be obtained from that State than from Pennsylvania. What will be the result of this move? It will be the building up of a town in New-Jersey, and the investment of some millions of Pennsylvania capital, to give employment to the poor, and pay taxes to the former State.[156]

And in 1873, the governor of New York remarked on New Jersey's success in attracting labor and capital through favorable tax and other laws:

> The natural advantages of New York, especially for commerce, far exceed those of other States; but they are not great enough to enable us to contend successfully with the rivalry of neighbors, quite as enterprising as ourselves, unless labor and capital are encouraged by laws as liberal as theirs.[157]

C. Emergence of the Internal Affairs Doctrine

It was in this context of weak-form territorial charter competition that courts first articulated the internal affairs doctrine.[158] Again, the typical internal affairs dispute

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> no relations whatever to New Jersey, transacting no business within her limits, having no stockholders, no officers, not even an office in the State, and consequently having no right to be identified with it in any way, have at different times been created by our pliant legislators . . . .
>
> Is it to be supposed that such men as constitute the majority of our legislators, were considered better qualified . . . than the legislators of New York, Pennsylvania, or Massachusetts? Or, was it not rather owing to a belief that they could be more easily cajoled in giving a legal existence to the incorporation than personages in like positions elsewhere?

Id. at 178-79 (quoting the NEWARK DAILY ADVERTISER, Feb. 25, 1862). And in any event, the revenues generated from these out-of-state projects were trivial, since corporate charters were not yet priced with the intention of raising revenues directly from chartering fees.

156. CADMAN, *supra* note 81, at 37 n.30 (quoting ONE OF THE PEOPLE, AN ENQUIRY INTO THE PROPRIETY OF GRANTING CHARTERS OF INCORPORATION FOR MANUFACTURING AND OTHER PURPOSES, IN SOUTH CAROLINA 9 (1845)). Cadman recounts New Jersey special charters granted as early as 1815 and 1823 for businesses previously incorporated in New York. The latter explicitly recited that the managers contemplated moving the firm to New Jersey and that the legislature recognized the benefit to the state from the employment of capital there. *See id*. at 37.

157. CADMAN, *supra* note 81, at 177 (quoting VI MESSAGES FROM THE GOVERNORS 530).

158. Richard Buxbaum summarizes this context:

> The American states could afford state of incorporation rather than *siège* reference points for their choice of law rule because at the time of that rule's first appearance their substantive regulatory laws did not permit, and federal constitutional law did not require them to permit, the type of foreign corporate emplacement in host states that the internal affairs concept describes and that it is the function of the *siège* notion to render harmless—local shareholders, local workforce and local sales. Recourse to the state of incorporation to identify the governing law was perfectly safe, given this limited right of mobility.

Richard M. Buxbaum, *The Origins of the American "Internal Affairs" Rule in the Corporate Conflict of Laws*, involved a shareholder suing in her home state to enforce rights against a foreign corporation in which she had invested.[159] Courts relied on traditional pre-industrial notions of territorial sovereignty to refuse jurisdiction over disputes involving foreign corporations' internal affairs. This jurisdictional bar was consonant with the private interests of state legislatures endeavoring to preserve their now-contested regulatory authority over local economic activity.

1. Articulation by the Courts

Early decisions enunciating the internal affairs doctrine echoed pre-industrial notions of states' sovereignty over their domestic corporations. Sovereignty considerations required deference to the incorporating state, and courts of other states did not have jurisdiction to address questions of corporate internal affairs. This jurisdictional bar "does not merely regard the powers of the court, but rather the extent of the state authority which underlies those powers. *It is in the nature of a question of sovereignty*."[160]

Internal affairs decisions before the merger movement were not many, and judging from that relative handful of decisions, courts seemed to find their jurisdictional limitations in this area fairly self-evident. They consistently noted the special role of the incorporating state, the state under whose laws the corporation was created and on which its existence depended.[161] Courts of one state possessed no visitorial powers over corporations of another state.[162] Only the incorporating state enjoyed such visitorial powers:

> It is the duty of the state to provide for the collection of debts from foreign corporations, due to its citizens . . . and it is the duty of the state to protect its citizens from fraud, by all the means in its power, whether against domestic or foreign wrongdoers. This, however, does not authorize the courts to regulate the internal affairs of foreign corporations. The courts possess no visitorial power over them. We can enforce no forfeiture of charter for violation of law; nor can we remove directors for misconduct. These powers all properly belong to the courts of the state from which they derive their existence.[163]

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in FESTSCHRIFT FÜR GERHARD KEGEL, 75-94 (1987).

159. *See, e.g.*, Howell v. Chicago & Nw. Rwy. Co., 51 Barb. 378 (N.Y. Sup. Ct. 1868) (involving shareholder suit in New York to continue injunction against payment of stock dividend by non-New York corporation); N. State Copper and Gold Min. Co. v. Field, 20 A. 1039, 1040 (Md. 1885) (involving suit by Maryland shareholder in North Carolina corporation, objecting to directors' declaration of shareholder's forfeiture of stock by reason of failure to pay shareholder assessment).

160. Smith v. Mut. Life Ins. Co., 96 Mass. 336, 339 (1867) (emphasis supplied).

161. *E.g.*, *id.* at 341; Howell v. Chicago & Nw. Ry. Co., 51 Barb. 378 (N.Y. Sup. Ct. 1868) (denying a motion to continue an injunction restraining the payment of a dividend because of lack of jurisdiction).

162. *Id.*; N. State Copper and Gold Mining Co. v. Field, 20 A. 1039, 1040 (Md. 1885).

163. *Howell*, 51 Barb. at 378. In Wisconsin, a corporation was seen to have a duty to keep its principal place of business, its records, and the residence of its principal officers all within the incorporating state to assure the corporation's amenability to the state's visitorial powers. Breach of such a duty might result in a forfeiture of the corporation's charter. State *ex rel.* Attorney Gen. v. Milwaukee, Lake Shore & W. Ry. Co., 45 Wis. 579 (1878).

Echoing a similar view, Angell & Ames wrote in 1866:

In addition to state sovereignty considerations, courts also noted the practical wisdom of the doctrine. Courts recognized the territorial limits of their own authority. They wished to avoid adopting decisions that would require enforcement in other states. Taking jurisdiction "would be assuming a power which the court ought not to exercise, and rendering a judgment which could not be enforced against the company in the place of its existence."[164] In addition, consistent with modern functionalist explanations for the doctrine, some courts recognized that the jurisdictional bar avoided subjecting corporations to conflicting decisions and inconsistent obligations.[165]

One might have thought that the rise of general incorporation, national product markets, and private profit making firms of national scope would put some pressure on the earlier ideology of the corporation as a public agency created by its sovereign. As early as 1819, the famous *Dartmouth College* decision, best known for its explication that "[a] corporation is an artificial being,"[166] also recognized that not all corporations were auxiliaries of the state. Instead, some were private vehicles to accomplish the private goals of their founders. The mere fact of incorporation did not render them public institutions.[167] In addition, state investment in domestic corporations was also becoming less common and less popular by mid-century. For many states, these investments turned sour after the Panic of 1837.[168] In state after state, constitutional prohibitions against such investment were enacted beginning in 1845.[169]

However, even as to private corporations with limited ongoing state involvement, a strong sense continued to exist that they were territorially and conceptually bound to their incorporating state—that they depended for their existence on the state of incorporation and had no legal existence outside that state except as the comity of other states might

> To render the charters or constitutions, ordinances, and by-laws of corporations of perfect obligation, and generally to maintain their peace and good government, these bodies are subject to *visitation*; or, in other words, to the inspection and control of tribunals recognized by the laws of the land. Civil corporations are visited by the government itself, through the medium of the courts of justice . . . . Civil corporations, . . . being created for public use and advantage, properly fall under the superintendency of that sovereign power whose duty it is to take care of the public interest . . . .

ANGELL & AMES, *supra* note 127, § 684 (emphasis in original).

164. Redmond v. Enfield Mfg. Co., 13 Abb. Pr. (n.s.) 332, 334 (N.Y. Sup. Ct. 1872); *see also Howell*, 51 Barb. at 393-84; N. State Copper & Gold Mining Co. v. Field, 20 A. 1039, 1041 (Md. 1885).

165. *See N. State Copper*, 20 A. at 1041 (noting prospect of "conflicting decisions," "interminable confusion," and "judgments and decrees that the courts of Maryland would be unable to enforce"). This turned out to be especially problematic for mutual insurance companies, whose policyholders were also its shareholders. "[N]o corporation could ever venture to conduct business beyond the limits of the State of its creation. . . . It might have a half dozen courts, in as many different States, requiring discovery, and demanding the production of books, and directing the statement of accounts, all at the same time." Clark v. Mut. Reserve Fund Life Ass'n, 14 App. D.C. 154, 178-79 (1899); *see also* Taylor v. Mut. Reserve Life Ass'n of New York, 33 S.E. 385, 389 (Va. 1899).

166. Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 581, 636 (1819).

167. *Id.*

168. The Panic of 1837 was precipitated by President Andrew Jackson's specie circular in 1836 that the U.S. Treasury would no longer accept bank notes as payment for public lands. Instead, only payment in specie—gold and silver coins—would be accepted. The deflationary pressure from this official lack of confidence in paper money caused widespread bank failures and economic depression. RONALD E. SEAVOY, THE ORIGINS OF THE AMERICAN BUSINESS CORPORATION, 1784-1855, at 138, 151 (1982).

169. *See* CADMAN, *supra* note 81, at 195-96.

allow. Consistent with this view, the 1850s and 1860s saw a broadening of the idea of "public purpose" to justify exercise of eminent domain powers by private companies. Manufacturing and mining companies, as well as transport companies and other traditional beneficiaries of eminent domain powers, now enjoyed the exercise of public power in pursuit of private wealth.[170] With *Paul v. Virginia*,[171] discussed in more detail below, the Supreme Court in 1868 reaffirmed this territorial view of corporate existence.[172]

2. Legislators' Private Interests

In this context of territorial corporate law, the internal affairs doctrine was consistent with legislators' private interests. Legislatures would therefore have had no private cause to expand the jurisdiction of their state courts to entertain suits by local investors over the internal affairs of foreign corporations.

The deference to the incorporating state embodied in the doctrine, far from enabling competition, served instead to reinforce each state's market power over its local firms with respect to corporate law. Courts' consistent approach to internal affairs decisions effected an implicit reciprocity among states,[173] assuring each state that sister states would not interfere in the internal affairs of its domestic corporations. The doctrine helped to effect market sharing over corporate law, consistent with state legislatures' general attempts to perpetuate their regulatory control over economic activity within their state borders.

The internal affairs doctrine was also consistent with each state's pursuit of its own economic development. In their mercantilistic rivalries, states would generally have attempted to discourage the export of local capital. The doctrine furthered this goal, closing the local courthouse doors to the complaints of local investors in foreign corporations, whose capital was likely being utilized in the incorporating state and not in the forum state. States effectively refused to come to the aid of local capital exporters—local promoters and other investors setting up and financing businesses in neighboring states. While no evidence suggests that this rationale helped motivate the internal affairs doctrine, it may help to explain why legislatures would have been perfectly happy with the doctrine and would have seen no reason to tinker with it. Disgruntled local investors in foreign corporations were likely to have been few and diffuse during this period. They would have been difficult to organize ex ante to petition for change in the jurisdictional rule.[174]

170. *See* JAMES WILLARD HURST, LAW AND THE CONDITIONS OF FREEDOM IN THE NINETEENTH-CENTURY UNITED STATES 63-64 (1956); Scheiber, *supra* note 74, at 95-96. Eminent domain powers, of course, could only be exercised within the granting state.

171. Paul v. Virgina, 75 U.S. 168, 181 (1868).

172. *See infra* notes 177-181 and accompanying text. Even after the merger movement and the formation of the great trusts as holding companies with national reach, courts relied on these same state sovereignty ideas in articulating the internal affairs doctrine. *See infra* note 326.

173. *See* Michael E. Solimine, *Forum-Selection Clauses and the Privatization of Procedure*, 25 CORNELL INT'L L.J. 51, 76 & n.157 (1992) (applying game theory approach to explain implicit judicial cooperation through precedent).

174. *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 43-52 (Schocken 1965) (describing the difficulty of organizing diffuse groups for political action).

It is important also to note what the early internal affairs decisions did *not* do. Because the early internal affairs decisions occurred in an environment of territorial corporate law, firms did not enjoy an unbridled choice of corporate law. Unlike the modern context, therefore, the internal affairs doctrine did not vindicate private choice. Instead, each corporation had a home state, in which it was physically located and under whose laws—including corporate law—it was regulated. In this context, the internal affairs doctrine merely left to the home state the regulation of its own corporations.

D. State Regulation of Foreign Corporations

I conclude the discussion of this industrialization period by addressing a misconception about the timing of strong-form charter competition and the role of Constitutional doctrine in bringing this competition about. As earlier noted, certain Commerce Clause decisions of the period facilitated an integrated national market in goods.[175] At the same time, other Commerce Clause decisions wrestled with the question of states' latitude to regulate foreign corporations. The seminal case was *Paul v. Virginia* in 1868.[176] Some commentators have suggested that *Paul* effectively precluded states from regulating foreign corporations. On this view, the decision single-handedly mandated universal respect for firms' choice of corporate law, creating a national market for corporate charters and causing strong-form charter competition. One implication of this view is that the internal affairs doctrine—deferring to the law of the incorporating state—was Constitutionally required.

In this section, I discuss *Paul* and its implications. I show that *Paul* could not and did not lead directly to strong-form charter competition or mandate universal deference to the incorporating state in matters of internal corporate affairs. Instead, charter competition came several decades after *Paul*, and the story of the internal affairs doctrine is not nearly so simple.

1. The Commerce Clause and State Control of Foreign Corporations

Paul v. Virginia settled two important Constitutional questions for foreign corporations. First, it reaffirmed the holding of *Bank of Augusta v. Earle*[177] that a corporation is not a "citizen" entitled to the protections of the Privileges and Immunities Clause.[178] Second, while also finding it "undoubtedly true" that corporations enjoyed the protections of the Commerce Clause,[179] the Court made clear that for economic activity that did *not* qualify as interstate commerce, states were free to regulate and discriminate against foreign corporations. The court denied a Commerce Clause challenge to a Virginia statute imposing licensing requirements on foreign corporations doing an insurance business, finding that the insurance business did not constitute interstate "commerce."[180] The decision explicitly reserved to the states broad latitude to regulate foreign corporations or even exclude them entirely, provided they were not engaged in

175. *See supra* notes 118-122 and accompanying text.
176. *Paul*, 75 U.S. 168.
177. 38 U.S. 519 (1839). *Bank of Augusta* is discussed *supra* notes 97-101 and accompanying text.
178. U.S. CONST. art. IV, § 2; *Paul*, 75 U.S. at 177.
179. *Paul*, 75 U.S. at 180.
180. *Id.* at 183.

interstate commerce.

> The corporation being the mere creation of local law, can have no legal existence beyond the limits of the sovereignty where created . . . . The recognition of its existence even by other States, and the enforcement of its contracts made therein, depend purely upon the comity of those States—a comity which is never extended where the existence of the corporation or the exercise of its powers are prejudicial to their interests or repugnant to their policy. Having no absolute right of recognition in other States, . . . it follows, as a matter of course, that such assent may be granted upon such terms and conditions as those States may think proper to impose. They may exclude the foreign corporation entirely; they may restrict its business to particular localities, or they may exact such security for the performance of its contracts with their citizens as in their judgment will best promote the public interest. The 'whole matter rests in their discretion.'[181]

This power to exclude foreign corporations we can think of as the ultimate rejection of the internal affairs doctrine. Exclusion of foreign corporations meant that only a firm willing to take a domestic charter could qualify to do intrastate business as a corporation.[182] *Paul*, then, effectively left to states the discretion to regulate the internal affairs of foreign corporations doing intrastate business.

In rejecting the Commerce Clause challenge, the *Paul* court left an important negative implication as well: that the Commerce Clause forbade states from excluding or regulating foreign corporations engaged in *interstate* commerce.[183] Commentators have claimed that this Commerce Clause prohibition explains the emergence of state charter competition, implying as well that the internal affairs doctrine was Constitutionally mandated. On this view, *Paul* created a national corporate charter market and triggered fervent charter competition. One scholar notes that after *Paul*,

> interstate enterprises could shop for the most favorable state of incorporation, and some of the smaller states began to 'liberalize' or 'modernize' their corporation laws in 'charter-mongering' competition or, stated more euphemistically, to meet the needs of modern business. New Jersey became the

181. *Id.* at 181. Recognizing corporate privileges and immunities would lead to unthinkable results:

> States would be unable to limit the number of corporations doing business therein. . . . They could not repel an intruding corporation, except on the condition of refusing incorporation for a similar purpose to their own citizens; and yet it might be of the highest public interest that the number of corporations in the State should be limited; that they should be required to give publicity to their transactions; to submit their affairs to proper examination; to be subject to forfeiture of their corporate rights in case of mismanagement, and that their officers should be held to a strict accountability for the manner in which the business of the corporations is managed, and be liable to summary removal.

Id. at 182.

182. *See* Ry. Express Agency, Inc. v. Virginia, 282 U.S. 440, 444 (1931).

183. This negative implication of *Paul* was made explicit in later cases. *See* Pensacola Tel. Co. v. W. Union Tel. Co., 96 U.S. 1 (1877); Crutcher v. Kentucky, 141 U.S. 47 (1891); *see also* HENN, *supra* note 144, at 17-18; HENDERSON, *supra* note 107, at 114.

> first 'mother of corporations' in 1875.[184]

Another scholar argues:

> The impact of *Paul v. Virginia* on the legislative market for corporate privileges was enormous . . . . Once the spatial monopolies for corporate privileges had fallen away after Paul, [o]ne opportunity open to states was to pass liberal general laws to attract incorporators from across the nation and to increase the revenues of the legislators' home states with taxes and franchise fees on the firms chartered under their laws but operating in other states. In essence, state legislators were presented with the opportunity to export some of the costs of their state government.[185]

This analysis implies that after *Paul*, states saw little latitude to regulate the internal affairs of foreign corporations. For foreign corporations engaged in interstate commerce, imposition of local corporate rules might have run afoul of the Commerce Clause.[186] In addition, under this analysis, *Paul*'s clear reservation of regulatory authority over *intrastate* commerce was apparently not a significant reservation. Interstate commerce was apparently so ubiquitous, and foreign corporations engaged in interstate commerce so numerous, that *Paul* led directly to states' universal deference to firms' choice of corporate law. On this view, states' territorial monopolies on corporate law ended because the dominant presence of foreign corporations in *interstate* commerce swamped any theoretical powers states retained over *intrastate* commerce. The competitive pressure to liberalize corporate law and to honor firms' chosen corporation law became irresistible.

If this analysis were correct, then the origin and persistence of the internal affairs doctrine would be a mere footnote in the interstate commerce story. If after *Paul*, the Commerce Clause removed significant swaths of economic activity—and the foreign corporations engaged in that activity—from the sphere of state regulation, then states' patterns of deference to firm's choice of corporation laws would then not be puzzling, since there would appear to be some Constitutional command for such an approach with respect to large—even dominant—sectors of the economy. If only trivial economic activity remained for state regulation, states might not have bothered.

2. The Significance of Intrastate Business

The above rendering overstates the significance of *Paul* and its negative implication regarding interstate commerce. The implied prohibition on regulating interstate commerce was not a major limitation on states' ability to regulate foreign corporations. Important industries remained within the sphere of state control, and states were

184. HENN, *supra* note 144, at 17. Others have claimed, incorrectly, that corporate charter competition was Constitutionally mandated by *Santa Clara County v. Southern Pacific Railroad Co.*, 118 U.S. 394 (1886). *See* NADER ET AL., *supra* note 130, at 47; Seligman, *supra* note 31, at 268. Contrary to the claims, *Santa Clara* did not discuss the question whether a corporation qualified as a "citizen" under the Privileges and Immunities Clause. It did hold that corporations were "persons" for purposes of equal protection under the Fourteenth Amendment. *See Santa Clara*, 118 U.S. at 394-95.

185. Butler, *supra* note 101, at 155-56.

186. HENDERSON, *supra* note 107, at 116. "For if the right to exclude is denied, the right to admit on condition necessarily falls with it." *Id*.

generally confident of their legal authority to use corporate law to regulate foreign corporations. True, important industries—railroads and telegraph companies, for example—came within the definition of interstate commerce,[187] and states might plausibly have competed for corporate chartering revenues from these firms. However, significant economic activity remained within the bounds of *intrastate* commerce, such that states' ability to exclude foreign corporations or admit them on conditions was no small reservation of legal powers. Moreover, it took twenty years after *Paul* for New Jersey to begin actively marketing corporate charters to firms without economic ties to the state. Its pursuit of chartering revenues through modifications to and active marketing of its corporate law did not begin until 1888.[188]

Important industries such as agriculture, forestry, manufacturing, and mining operations, as well as insurance, were clearly not considered interstate commerce at the end of the nineteenth century and were therefore not shielded from state regulation under the Commerce Clause.[189] Likewise, a foreign corporation could own property or maintain offices or warehouses only at the sufferance of the host state.[190] Therefore, while foreign corporations might deliver goods into a state free from local regulation or taxation, Commerce Clause protection might not extend much further in protecting other of their economic activities outside their incorporating states.

After *Paul*, the Court repeatedly affirmed states' power to discriminate against foreign corporations by declaring that certain business activities—like manufacturing and mining—did not constitute interstate commerce.[191] And strong evidence exists that these intrastate businesses subject to state control predominated; they were not exceptional.[192]

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187. *See* JOSEPH HENRY BEALE, JR., THE LAW OF FOREIGN CORPORATIONS 178-79, § 129 (1904); W. DRAPER LEWIS, THE FEDERAL POWER OVER COMMERCE AND ITS EFFECT ON STATE ACTION 15-16 (1892).

188. *See infra* note 227 and accompanying text.

189. Barry Cushman, *Formalism and Realism in Commerce Clause Jurisprudence*, 67 U. CHI. L. REV. 1089, 1120 (2000); *see also* Robert A. Schapiro & William W. Buzbee, *Unidimensional Federalism: Power and Perspective in Commerce Clause Adjudication*, 88 CORNELL L. REV. 1199, 1209-11 (2003) (noting court's manufacture/commerce dichotomy and criticizing court's categorical approach as "unidimensional"). Beginning in 1910, however, Supreme Court decisions began to characterize foreign corporations' Fourteenth Amendment equal protection rights—first enunciated in *Santa Clara County v. Southern Pacific Railroad Co.*, 118 U.S. 394 (1886)—as rights of nondiscrimination. *See* S. Ry. Co. v. Greene, 216 U.S. 400 (1910); Herndon v. Chic., Rock Island & Pac. Ry. Co., 218 U.S. 135 (1910); Interstate Amusement Co. v. Albert, 239 U.S. 560 (1916); Phoenix Ins. Co. v. McMaster, 237 U.S. 63 (1915). These cases clearly curtailed states' power to exclude foreign corporations. *See* HENDERSON, *supra* note 107, at 148-62. This would not generally affect states' latitude to regulate foreign corporations' internal affairs, however, since states doing so would typically only be applying the rules applicable to domestic corporations.

190. *See* Coe v. Errol, 116 U.S. 517, 527 (1886) (holding that for corporation owning property, plants, mines, or maintaining offices and warehouses in foreign states, its property necessarily became "part of the general mass of property in the State, subject as such to its [taxing and regulatory] jurisdiction").

191. Pembina Mining Co. v. Pennsylvania, 125 U.S. 181 (1888); Horn Silver Mining Co. v. New York, 143 U.S. 305 (1892); New York v. Roberts, 171 U.S. 658 (1898); Am. Sugar Ref. Co. v. Louisiana, 179 U.S. 89 (1900); Diamond Glue Co. v. U.S. Glue Co., 187 U.S. 611 (1903); Hemphill v. Orloff, 277 U.S. 537 (1928); Ry. Express Agency, Inc. v. Virginia, 282 U.S. 440 (1931).

192. The Court's decision in *Horn Silver Mining Co. v. New York*, 143 U.S. 305 (1892), suggests that interstate commerce was the exceptional situation, and that states' power to exclude foreign corporations or admit them on conditions was the rule.

> As to a foreign corporation, . . . it can claim a right to do business in another State, to any extent, only subject to the conditions imposed by its laws. . . . This doctrine has been so frequently

For example, in New England between 1863 and 1875, charters for mining and manufacturing companies constituted almost 70% of all corporate charters.[193]

Even during the heyday of the great merger movement, while New Jersey was instigating strong-form charter competition and reaping stupendous rewards from charter sales,[194] other states' officers expressed confidence in their legal authority to regulate foreign corporations generally. The annual report of the attorney general of Ohio for 1898 reflects the general understanding of states' broad powers over foreign corporations and the narrowness of the interstate commerce exception. For controlling trusts,

> the State is more powerful than the Federal Government . . . . The Federal Government's power in this behalf is limited to corporations doing an interstate business, while the State is sovereign over its own corporate creatures as well as over the franchises of foreign corporations exercised in the State's domain.[195]

Similarly, in 1903 a Massachusetts special legislative committee on corporation laws reported that:

> [A] corporation cannot exercise its franchise in another state as a matter of legal right, but only on the principle of inter-state comity. Foreign corporations may be excluded entirely, or they may so taxed or otherwise burdened as to compel them to leave the state. They can be admitted to the state, and can exercise their corporate privileges therein, only upon conforming to such terms and conditions as a state may prescribe . . . . [F]oreign corporations . . . require the official sanction of the state in which they wish to do business.[196]

It appears, then, that states could have regulated significant economic activities in which foreign corporations were engaged. Contemporary corporate scholars agreed. In 1894, William Cook noted in his famous treatise, "[I]n nearly all particulars foreign corporations must bend to the will of the state."[197] Even after the merger movement, as late as 1929, corporate scholars complained about states' unwillingness to exercise their powers to regulate corporations:

> So far as powers go, each state is . . . amply able to regulate and control not

> declared by this court that it must be deemed no longer a matter of discussion, if any question can ever be considered at rest. Only two exceptions or qualifications have been attached to it in all the numerous adjudications in which the subject has been considered . . . . One of these qualifications is that the state cannot exclude from its limits a corporation engaged in interstate or foreign commerce.

Id. at 314. The other qualification was for corporations in the employ of the federal government. *Id.*

193. For mining and manufacturing, 3136 charters were granted, out of a total of 4575. Kessler, *supra* note 73, at 47. A charter grant did not always indicate the inception of a business; some charter grants went unused. But these numbers give some indication of the economic significance of intrastate business in New England.

194. *See infra* Part V.A.2.

195. 1898 OHIO ATT'Y GEN. ANN. REP. 19 (emphasis supplied). The attorney general further noted that "quo warranto is the true remedy to punish either domestic or foreign corporations when they violate the public policy of the State by monopolistic contracts, or when they openly defy the anti-trust laws or any other laws of the State." *Id.*

196. MASSACHUSETTS REPORT, *supra* note 113, at 290-91 (citations omitted).

197. 2 WILLIAM W. COOK, A TREATISE ON STOCK AND STOCKHOLDERS, BONDS, MORTGAGES AND GENERAL CORPORATION LAW § 697, at 1005 (3d ed. 1894) (1887).

> only the corporations which it itself creates, but also foreign corporations . . . . The causes that give rise to the corporation problem are not to be found in any limitation in the powers of the states over corporations, but in their failure to exercise those powers with sole reference to the promotion of the public interest . . . . [P]rivate interests and selfish interests of individual states in the revenue they can derive through incorporating companies to carry on business in other jurisdictions have served to give an unfortunate direction to American corporation legislation.[198]

For political and economic reasons discussed below, most state legislatures ultimately chose not to exclude foreign corporations or deter their entry with significant regulation. Instead, legislatures—with a few notable lapses—forswore regulation of foreign corporations' internal affairs and liberalized their own corporate laws. But this did not occur until the 1890s with the great merger movement and New Jersey's active marketing of its non-territorial corporate law.[199] This reluctance to regulate foreign corporations' internal affairs was more or less a calculated response to economic conditions—especially the changing industrial organization brought about by technological innovation—and not a result of Constitutional mandate.[200]

V. THE GREAT MERGER MOVEMENT, CORPORATE CHARTER COMPETITION, AND POLITICAL ECONOMY

The story of corporate charter competition among the states—and the explanation for the persistence of the internal affairs doctrine in facilitating that competition—is inextricably bound with the story of the great merger movement at the end of the nineteenth century and New Jersey's pioneering strategy of marketing its corporation law to firms with no economic ties to the state. Strong-form charter competition began in earnest in the last decade of the nineteenth century, as New Jersey modified its corporation law specifically to attract incorporation by out-of-state firms.[201] New Jersey broke with the traditional territoriality of corporate law. It offered a corporation law unfettered with geographical or structural limitations. It supplied a corporate form suitable for housing the great trusts, earning for itself the moniker of "Traitor State."[202]

Other state legislatures could have resisted. They could have nullified firms' attempts to evade local corporate rules—in the process, rejecting or reworking the

198. HENRY R. SEAGER & CHARLES A. GULICK, JR., TRUST AND CORPORATION PROBLEMS 33-34 (1929). As late as 1931, the Supreme Court upheld a provision of the Virginia constitution that effectively required a foreign corporation to take out a Virginia charter in order to to do an intrastate express business. Ry. Express Agency, Inc. v. Virginia, 282 U.S. 440 (1931). Apparently, Virginia's law was designed to stop the flow of express companies reincorporating in West Virginia and New Jersey. Liggett Co. v. Lee, 288 U.S. 517, 560-61 (1833).

199. *See infra* notes 226-227 and accompanying text.

200. The division of regulatory power among the states and the federal government along the lines of intrastate versus interstate commerce no doubt created coordination problems in the face of interstate markets and firms. *See infra* note 263 and accompanying text. However, Commerce Clause dictates by themselves cannot explain widespread legislative acquiescence to the internal affairs doctrine in the context of modern charter competition.

201. *See* GRANDY, *supra* note 32, at 43.

202. *See infra* notes 226-249 and accompanying text.

existing internal affairs doctrine—by excluding tramp foreign corporations from doing intrastate business, or by imposing local corporate rules on these foreign corporations. However, state legislatures generally offered little resistance to New Jersey and the great trusts that incorporated there.

This Part explains the political economy of the internal affairs doctrine during and after the great merger movement. Legislators' and interest groups' stakes in the doctrine changed as a result of strong-form charter competition and the political and economic pressures that enabled that competition. Respect for the law of the incorporating state now effectively honored firms' choice of corporate law because firms now had a choice about where to incorporate. Under the prior system of territorial corporate law, by contrast, this same rule merely perpetuated legislatures' regulatory monopolies on corporate law. My project represents a bit of unconventional positive political economy insofar as it attempts to explain legislative *inaction*.[203] In the face of changed circumstances that rendered the extant internal affairs doctrine a pro-competition, rent-dissipating jurisdictional rule, legislators *failed* to act to change the judge-made rule. Definitive explanations for legislative inaction are no doubt difficult to construct.[204] However, I identify circumstances tending to explain why rational legislators would acquiesce to the extant internal affairs doctrine in the new pro-competitive context.

I first discuss state legislatures' reluctance to fight New Jersey or attempt to revisit the internal affairs doctrine. They did not attempt to salvage the rent-seeking potential for local corporate law, but were instead content to allow firms to choose their corporate law. With severe economic upheaval in the 1890s, each state needed the participation of the great trusts and other large interstate firms in its local economy. Collective action among state legislatures was not possible, and legislators feared driving business to a neighboring state. Therefore, they did not challenge foreign corporations' corporate status or attempt to impose local corporate rules. Local constituencies in each state benefited from their economic interaction with these foreign corporations, and state legislatures welcomed these firms' local activities. At the same time, legislatures relaxed the restrictions in their own corporation laws to head off moves by their remaining local firms to reincorporate elsewhere. Corporate law therefore lost any utility it might have had to favor local interests—primarily local producers and investors.

I then describe the New York legislature's exceptional but short-lived attempt to fight New Jersey by regulating the internal affairs of foreign corporations. While most legislatures accepted the new realities of charter competition and the extant internal

203. For a cautionary tale on the use of legislative inaction for statutory interpretation, see William N. Eskridge, Jr., *Interpreting Legislative Inaction*, 87 MICH. L. REV. 67 (1988).

204. Even explaining positive state corporate legislation during this period is hampered by the relative dearth of sources.

> Despite the importance of the subject, there is no abundance of direct evidence to identify the prime movers. The historian confronts here a problem of scarce sources familiar to the student of legal history. . . . [S]tate legislative records are typically a bare-bones collection. The press usually finds little that is newsworthy in what goes on at state capitols. . . . [T]here is little likelihood that the moving forces will be reflected in unofficial published papers. To a considerable extent we must identify interests and pressures and their resolution by inference from the formal decisions taken by legislatures and courts.

HURST, *supra* note 83, at 71 (internal citation omitted).

affairs doctrine in this new context, the New York legislature was atypical. It briefly imposed local corporate rules on foreign corporations in an attempt to discourage New Jersey reincorporation by its local businesses. With its own robust state economy, New York's legislature feared negative economic consequences less than did those of other states. But New York ultimately did not press the strategy.[205]

While local industrial organization and political economy were changing, the internal affairs doctrine did not. I conclude this Part with a note on the doctrinal consistency—the inertia—of the doctrine through the merger movement. Despite the demise of territorial corporate law, the rhetoric of courts' internal affairs decisions during and after the merger movement remained consistent with the earlier justifications: the sovereignty of the incorporating state remained an important concern. Courts acknowledged their disability to interfere in a foreign corporation's internal affairs, citing states' general lack of authority in the area.[206]

A. The Great Merger Movement and New Jersey

Toward the end of the nineteenth century, industrialization, urbanization, and the emergence of interstate markets and firms had led to industrial concentration across all industries. Driven in part by new scale economies[207] and in large measure by anticompetitive impulses, entire industries consolidated into one or a handful of national producers. Numerous industries became monopolized.[208] The great conglomerates required a legal form to house them. New Jersey ultimately obliged. This section recounts the familiar story of New Jersey's role in instigating modern corporate charter competition.

1. The Trusts and Corporate Law

John D. Rockefeller's Standard Oil Trust was the first great industrial monopoly. By 1880, he controlled 95% of all refined oil shipments in the United States.[209] To control this enormous set of businesses, Rockefeller needed a new and special form of business

205. California as well has never been shy about imposing local corporate rules to affect the internal affairs of foreign corporations. As early as 1876, it was willing to extend its rule of personal stockholder liability to foreign corporations doing business in the state. *See* Pinney v. Nelson, 183 U.S. 144 (1901) (upholding application of section 322 of the California Civil Code). California also adopted a broad constitutional provision in 1879 that "[n]o corporation organized outside the limits of this State shall be allowed to transact business within this State on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this State." CAL. CONST. art. 12, § 15 (1879).

206. *See infra* notes 326-329 and accompanying text.

207. From 1850 to 1920, the average manufacturing plant for agricultural implements increased its capital by over 260 times, its number of wage earners by almost 21 times, and the gross value of its output by 114 times. For iron and steel manufacturing plants, the average capital increased almost 107 times, the average number of wage earners increased by more than 11 times, and the value of output increased 119 times. Across all manufacturing plants, average capital increaed by 37 times, labor by almost 5 times, and the value of output by almost 26 times. JEREMIAH JENKS & WALTER E. CLARK, THE TRUST PROBLEM 17 (5th ed. 1929).

208. Eastern railroad corporations formed the first significant national monopolies. Eight railroad corporations together used their control over transportation to acquire 95% of the anthracite coal industry by 1893. Railroads monopolized other industries as well: bituminous coal, kerosene, matches, stoves, furnaces, steam and hot water heaters, boilers, gas pipelines, and candles. NADER ET AL., *supra* note 130, at 39.

209. *Id.* at 42.

entity. At the time, the corporate form was unavailable for such a colossal enterprise, given the myriad restrictions in the corporation laws of every state.[210] So Rockefeller's lawyer created the corporate trust. Under this 1882 arrangement[211]—involving forty corporations and limited partnerships and forty-six individuals—the various businesses were combined and trust certificates issued in exchange for the property, assets, or shares of the constituent businesses. The trust was managed by nine trustees elected by vote of the trust certificates, and certificates were transferable like shares of corporate stock.[212] Through this device, the Standard Oil Trust achieved a unified control over the enormous pool of assets necessary to its monopoly, while at the same time circumventing the structural restrictions of state corporate law and avoiding the public disclosure that incorporation would have required.

Other industrial trusts followed in short order.[213] By 1890, twenty-four trusts had been formed, with total capital of $376 million.[214]

The trusts provoked public outrage. The vast majority of corporations were still "relatively small affairs, financed for the most part through local subscriptions rather than by resort . . . to nationwide systems of security distribution or to stock exchanges."[215] State officials in six states attacked the trusts in court. New York and California went after the Sugar Trust;[216] Nebraska and Illinois sued constituents of the Whiskey Trust;[217] Louisiana filed suit against the Cotton-seed Oil Trust;[218] Illinois sued the Chicago Gas Trust, an unauthorized public utility holding company;[219] and Ohio sued Standard Oil.[220]

The legal theory relied upon did not directly address questions of monopoly or restraint of trade. Instead, these actions were brought under established corporate law

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210. Limits on capitalization, out-of-state operations and property holdings, and prohibitions of holding company structures were common. *See supra* Part IV.B.

211. An earlier agreement was struck in 1879, but its existence was not publicly known until 1906. The details of the 1882 agreement emerged first, during New York Senate hearings in 1888, and became the model for other trusts of the time. SEAGER & GULICK, *supra* note 198, at 49, 50 n.1; *see also* REPORT OF THE COMMITTEE ON GENERAL LAWS ON THE INVESTIGATION RELATIVE TO TRUSTS, N.Y. SEN. DOC. NO. 50 8-9 (1888) [hereinafter NEW YORK 1888 REPORT] (describing Standard Oil Trust under 1882 agreement).

212. SEAGER & GULICK, *supra* note 198, at 50.

213. The Cotton-seed Oil Trust was organized in 1884; the Linseed Trust in 1885. Three great trusts were created in 1887: the National Lead Trust, the Sugar Trust, and the Whiskey Trust. *Id.* at 51; Harold Underwood Faulkner, *Consolidation of Business*, *in* ROOSEVELT, WILSON, AND THE TRUSTS 7 (Edwin C. Rozwenc ed., 1950). For specific discussion of the formation and operation of the Sugar Trust, see REPORT OF THE COMMITTEE ON GENERAL LAWS RESPECTING ALL MATTERS RELATING TO "TRUSTS," AND ESPECIALLY "SUGAR TRUSTS," N.Y. SEN. DOC. NO. 79 4-9 (1891) [hereinafter NEW YORK 1891 REPORT].

214. NADER ET AL., *supra* note 130, at 42.

215. E. Merrick Dodd, Jr., *Statutory Developments in Business Corporation Law 1886-1936*, 50 HARV. L. REV. 27, 30 (1936) (describing state of affairs in 1886); *see also* Thomas R. Navin & Marian V. Sears, *The Rise of a Market for Industrial Securities, 1887-1902*, 29 BUS. HIST. REV. 105, 107 (1955) (noting that industrial firms of the late 1880s were "typified by small single-plant companies serving limited markets").

216. People v. N. River Sugar Ref. Co., 121 N.Y. 582 (1890); People v. Am. Sugar Ref. Co., 7 Ry. & Corp. L.J. 83 (Cal. 1890).

217. State v. Neb. Distilling Co., 29 Neb. 700 (1890); Distilling & Cattle Feeding Co. v. People, 156 Ill. 448 (1895).

218. *See* State v. Am. Cotton Oil Trust, 1 Ry. & Corp. L.J. 509 (La. 1887).

219. People v. Chi. Gas Trust Co., 130 Ill. 268 (1889).

220. State v. Standard Oil Co., 49 Ohio St. 137 (1892).

rules. Though Congress enacted the Sherman Antitrust Act in 1890[221] and state antitrust laws were also proliferating,[222] concerns about industrial concentration had traditionally been regulated through state corporate law. State-level regulation made sense when product markets were primarily local markets. Legislatures traditionally regulated industrial concentration, not by attacking private arrangements among producers, as is common under the Sherman Act. Instead, legislatures and other state officials relied on the structural limitations contained in their corporation laws—limitations on mergers, limitations on corporate capital, prohibitions on holding company structures.[223] The trust-busting suits continued with this traditional approach. The suits were brought as *quo warranto* actions to revoke the charters of the corporations that had abdicated control to the trusts. Such transfers of control were beyond the powers of the constituent corporations—clearly *ultra vires*. The suits succeeded. "Established principles of corporation law . . . provided adequate and effective weapons for the destruction of corporate combinations."[224]

2. New Jersey: The Traitor State

At the same time the trusts came under attack by officials of various states, New Jersey officials adopted a new tack in developing New Jersey's corporation law. As earlier noted, before the merger movement, state legislatures generally liberalized their corporation laws, not to sell corporate charters for their own sake, but typically as part of a program to attract and retain capital and labor in the state.[225] Offering attractive territorial corporate law was merely part of a general effort to create a favorable climate for business.

Beginning in 1888, New Jersey officials targeted firms without any necessary economic connection to the state. They hoped to raise revenue merely from the sale of corporate charters to firms with all or most of their operations elsewhere.[226] A new pricing strategy—taxing New Jersey corporations annually based on their authorized capital—created the potential for enormous revenues.[227] Corporate law became a

221. Charles W. McCurdy, *The* Knight *Sugar Decision of 1895 and the Modernization of American Corporation Law, 1869-1903*, 53 BUS. HIST. REV. 304, 328 (1979).

222. *See* JENKS & CLARK, *supra* note 207, at 213; 2 REPORT OF THE INDUSTRIAL COMMISSION 252A (facing page 264) (1900) [hereinafter INDUSTRIAL COMMISSION REPORT].

223. *See* Liggett Co. v. Lee, 288 U.S. 517, 550-56 (1933). In fact, the original version of the bill that became the Sherman Act proposed to attack interstate combinations in restraint of trade by authorizing federal officials to *dissolve* them, just as state officials could apply for the forfeiture of the charters of their domestic corporations. McCurdy, *supra* note 221, at 324.

224. McCurdy, *supra* note 221, at 322.

225. *See supra* notes 154-157 and accompanying text.

> [Corporate law] standards seem to have remained fairly high until about the last decade of the [nineteenth] century, when the combined needs of business for the corporation and of the state for revenue after long years of depression soon produced a sweeping change in the hitherto rigorous attitude of the state governments. As is well known, the first state to weaken was New Jersey.

William C. Kessler, *Business Organization and Management*, *in* THE GROWTH OF THE AMERICAN ECONOMY: AN INTRODUCTION TO THE ECONOMIC HISTORY OF THE UNITED STATES 602, 610 (Harold F. Williamson ed., 1951).

226. GRANDY, *supra* note 32, at 43.

227. Somewhat fortuitously, New Jersey had modified its method of taxing corporations a few years earlier.

product, and not just a marketing device.

James Brooks Dill, a New York lawyer who lived in New Jersey during the late 1880s, is generally credited with the idea of selling corporate charters to raise state revenues. After failing to convince New York politicians to adopt his scheme,[228] Dill went across the river to New Jersey.[229] He was able to convince the governor that his plan would succeed despite West Virginia's lack of success with a similar scheme. Dill's plan included an additional feature—a private corporation to actively advertise the benefits of New Jersey corporation law to out-of-state businesses.[230] Dill founded The Corporation Trust Company of New Jersey to perform this marketing function. Besides marketing, the trust company also facilitated New Jersey incorporation by providing the ministerial services necessary for out-of-state charter applicants to comply with the law's formal requirements. The trust company handled the filing of the certificate of incorporation with the secretary of state. It provided an address for the newly chartered corporation's principal office within the state. An employee of the trust company served as the new corporation's local agent for service of process.[231] Dill also saw to it that both

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In 1884, "[a]lmost as an afterthought" following passage of a new tax on railroads, the legislature enacted a corporate tax based on authorized capital. Grandy, *supra* note 113, at 680-81. Several years passed before anyone saw the revenue potential in this new method of taxation.

228. Stoke, *supra* note 75, at 571.

229. Lincoln Steffens recounts the story of how Dill got his inspiration. He had apparently heard that the secretary of state of West Virginia was set up in Manhattan with the state seal by his side, pitching the liberality of West Virginia's corporation law and selling charters for a fee. Lincoln Steffens, *New Jersey: A Traitor State*, 25 MCCLURE'S 41, 42 (1905).

230. Stoke, *supra* note 75, at 571; Steffens, *supra* note 229, at 43.

> Mr. Dill explained to Governor Abbett that, while his state had liberal laws, other states like Delaware and West Virginia were liberalizing their laws, and that while the advantages of Jersey were known to the great captains of industry, the little captains did not know about them. . . . What was wanted was a state that would not only open up its laws, but would advertise itself; that state would get the business, which would go forth with business push, advertising and drumming up trade among the businesses that never had heard of West Virginia, Delaware, and New Jersey as dealers in lawful license. Now a state, as a state, could not afford . . . to go out on the road showing its goods and advertising itself as the easiest, safest and best shop for limited-liability charters. The thing to do, therefore, was to make it worth while for a private company, incorporated under Jersey laws, to undertake this part of the business. So Mr. Dill proposed to form a company which, for small but numerous fees, should advertise Jersey as a charter-granting state, explain her laws, vouch for her courts, attend to the incorporation of commercial companies, and look out for them at home while they were off doing business in the other states.

Id. at 43-44.

231. GRANDY, *supra* note 32, at 40. The Corporation Trust Company advertised:

> We will attend to every detail, including, if you desire, the organization of your company, notify you of all meetings you are required to hold, and see that they are legally conducted . . . .
>
> We have employees of this office who act as incorporators, who would sign the charter and complete the organization, returning to you all the papers ready to do business in three days . . . .
>
> The State requires that one director be a resident of this State whom we will furnish if desired without extra charge.

Stoke, *supra* note 75, at 573 (citation omitted). The webpage for CT Corporation, a premier corporation services company, describes the range of services that a modern corporation services company provides. *See* CT Advantage Tools For Success, http://www.ctadvantage.com/public/lawFirmCustomers.html (last visited Sept. 6, he and important politicians personally profited from the chartermongering strategy. The clerk of chancery served as an incorporator for the Corporation Trust Company, and the governor and secretary of state both served as directors. The latter eventually became president of the company.[232]

New Jersey's timing was excellent. Critical amendments were enacted beginning in 1888 that facilitated holding company structures and consolidations, exactly the legal tools the great trusts needed that corporate law had not theretofore offered.[233] These corporate law revisions allowed the great trusts simply to reincorporate in New Jersey after having been dismembered by *quo warranto* actions in other states.[234] In a particularly galling example, following the New York state attorney general's successful suit to revoke the charter of a New York corporation for its illegal participation in the Sugar Trust,[235] the firm immediately reincorporated in New Jersey and continued doing business in New York.[236]

2006).

232. GRANDY, *supra* note 32, at 40. His involvement "must have proven particularly useful as the secretary of state's office regularly received inquiries about the law and referred them to one of the corporation service companies." *Id.* (citation omitted).

233. An 1888 act allowed New Jersey corporations to hold stock in other corporations, thereby enabling holding companies. Stoke, *supra* note 75, at 571; Keasbey, *supra* note 125, at 207 (citing 1888 N.J. Laws 385).

An 1891 law permitted corporations to purchase stock or other property using their own stock in payment, with great deference given to the directors' judgment. Stoke, *supra* note 75, at 571 (citing 1891 N.J. Laws 329). This deference was important in allowing acquiring corporations to pay handsomely for their acquisitions by issuing their own stock as consideration. A generous helping of stock assured the acquiescence of the target's owners, and the statutory deference to directors' judgment insulated the acquirer's directors from the complaints of their pre-existing shareholders concerning the massive dilution of their shares caused by issuance of the additional stock in the acquisition. A general revision of the corporation statute in 1896 rendered *conclusive* the directors' judgment as to the value of property purchased. 1896 N.J. Laws 313. "This meant putative monopolists could buy up competing corporations without paying a penny in cash while offering the owners of the acquired corporation stock worth far more than the assets of the acquired firm. Everyone profited but the public investor." Seligman, *supra* note 31, at 266.

In 1892, New Jersey repealed its antitrust statute. Keasbey, *supra* note 125, at 209 (citing 1892 N.J. Laws 200). It also made explicit that corporations could be formed to do all their business outside the state. Liggett Co. v. Lee, 288 U.S. 517, 563 & n.44 (1933) (citing 1892 N.J. Laws 90). General authority for mergers was enacted in 1893. GRANDY, *supra* note 32, at 43 (citing Act of Mar. 8, 1893, ch. 67, 1893 N.J. Laws 121). This general merger statute offered enormous flexibility to corporations. It contained a general enabling provision, authorizing a merger agreement to contain "all such other provisions and details as . . . [the] directors shall deem necessary to perfect the merger or consolidation." *Id.* at 43-44 (citing Act of Mar. 8, 1893, ch. 67, 1893 N.J. Laws 121, § 2). It also gave tremendous flexibility as to the financing of mergers, authorizing issuance of common and preferred stock and debt to pay for acquisitions. *See id.* at 44 (citing Act of Mar. 8, 1893, ch. 67, 1983 N.J. Laws 121, § 6). The same year also saw a broadening of authority for holding companies. *Id.* at 43 (citing Act of Mar. 14, 1893, ch. 171, 1893 N.J. Laws 301).

234. A general revision of the corporation act in 1896 removed the then-existing fifty-year limit on corporate life. A corporation could be formed for any lawful purpose and could carry on business in any state or any foreign country. A corporation was free to lease its holdings or franchise to another corporation. Taxes were set at a "rate of one-tenth of one percent of the par value of stock issued up to three million, and five dollars for each one hundred thousand or part thereof above five million." Stoke, *supra* note 75, at 572 (citing 1896 N.J. Laws 313). This latter provision was important for eliminating the tax collectors' discretion from the calculation of the corporation's tax bill.

235. People v. N. River Sugar Ref. Co., 121 N.Y. 582 (1890).

236. NEW YORK 1891 REPORT, *supra* note 213, at 10-14.

Corporations, especially the largest ones, flocked to New Jersey.[237] Following an 1896 revision, the largest corporations came in droves.[238] By 1899, all the trusts that had been successfully attacked by state attorneys general in the preceding decade had re-emerged as New Jersey corporations.[239]

In addition to housing the great trusts, New Jersey also dominated more generally as the incorporation jurisdiction of choice in the great merger movement. Dramatic consolidation occurred in major industries between 1895 and 1904. During that period over 1800 manufacturing firms were merged out of existence. Half of the surviving firms enjoyed national market shares in excess of 40%; one-third of the surviving firms enjoyed national market shares exceeding 70%.[240] In those years, for mergers exceeding $1 million in capitalization, nearly 80% of the capitalization came under a New Jersey charter.[241] The next leading incorporating state, New York, accounted for a mere 3.7% of capitalization.[242]

As a fiscal matter as well, the chartering business was wildly successful for New Jersey.[243] In 1896, it garnered over $857,000 in franchise fees. By 1900, its franchise fee revenues had more than doubled, approaching $1.8 million that year. By 1904, that figure had almost doubled again, reaching $3.4 million.[244] From 1896 to 1904, New Jersey chartered over 15,000 corporations.[245] It had extinguished its state debt by 1902—including Civil War debt that had amounted to $2.5 million as of 1875—and eliminated its property tax.[246] By 1905, New Jersey had a surplus approaching $3 million.[247] The governor boasted:

237. According to one account, as of early 1891, 1626 corporations had been chartered in New Jersey in two years. Stoke, *supra* note 75, at 573.

238. In the seven years from 1897 to 1904, 104 corporations were chartered in New Jersey with capital of $20 million or more. Only fifteen of such large enterprises had been incorporated in New Jersey in the preceding sixteen years. GEORGE HEBERTON EVANS, JR., BUSINESS INCORPORATIONS IN THE UNITED STATES, 1800-1943, at 49 (1948).

239. McCurdy, *supra* note 221, at 322-23 (citing 19 INDUSTRIAL COMMISSION REPORT, *supra* note 222, at 598-99). United States Steel Corporation, then the largest company in America, incorporated in New Jersey in 1901 with a total capitalization of $1.37 billion. *Id*. Besides Standard Oil and U.S. Steel, the other five of John Moody's seven "Greater Industrial Trusts" also incorporated in New Jersey, as well as more than half of his "Lesser Industrial Trusts." JOHN MOODY, THE TRUTH ABOUT TRUSTS 453-69 (1904). Moody's great industrial trusts were Amalgamated Copper, American Smelting and Refining, American Sugar Refining, Consolidated Tobacco, International Mercantile Marine, Standard Oil, and U.S. Steel. *Id.*

240. NAOMI R. LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895-1904, at 2 (1985).

241. *See* RALPH L. NELSON, MERGER MOVEMENTS IN AMERICAN INDUSTRY, 1895-1956, at 67 (1959) (displaying percentages of total consolidation activity in leading states).

242. *Id.*

243. Besides the fortuitous taxing structure put into place in 1884, see *supra* note 227, New Jersey implemented an effective enforcement device to keep its corporations paying their annual franchise taxes. In 1891, the governor was given the authority to revoke the charters of delinquent corporations, and each year's gubernatorial proclamation included an extensive list of such delinquent corporations. Later, the legislature also provided for a ninety-day grace period, during which delinquent firms could buy their amnesty and reinstatement by paying the back taxes, interest, and fees. GRANDY, *supra* note 32, at 44.

244. *See* Seligman, *supra* note 31, at 267 (citing various sources).

245. *Id*.

246. GRANDY, *supra* note 32, at 46.

247. Seligman, *supra* note 31, at 268.

> Of the entire income of the government, not a penny was contributed directly by the people . . . . The state is caring for the blind, the feeble-minded, and the insane, supporting our prisoners and reformatories, educating the younger generations, developing a magnificent road system, maintaining the state government and courts of justice, all of which would be a burden upon the tax-payer except for our present fiscal policy. To have raised last year, by direct taxation, the income of the state, would have imposed upon property a tax rate of nearly one-half of one per cent.[248]

Its singular success in the sale of corporate charters earned New Jersey the now infamous moniker of "Traitor State."[249]

B. Potential Resistance by Other States

Officials in other states faced a crucial choice during this period of industry consolidation and New Jersey's stunning modifications of its corporation law. They could either fight New Jersey and its tramp corporations, or they could succumb. While officials in many states condemned New Jersey's charter selling strategy, and a few studiously mimicked it,[250] most just reluctantly succumbed. State legislatures did not attempt to exclude New Jersey corporations or impose local corporate rules on them or prevent domestic corporations from being acquired by New Jersey holding companies. Instead, state legislatures generally recognized foreign corporations' corporate status and their choice of foreign corporate law—leaving the existing internal affairs doctrine intact despite its very different consequences from the days of territorial corporate law. State legislatures also followed New Jersey's lead on many aspects of corporation law, content to modify their laws sufficiently to defend against the tide of their domestic corporations seeking new charters from New Jersey. Only a few isolated instances of resistance occurred.[251]

The legal tools for resisting New Jersey were readily available. State officials clearly possessed the legal authority to exclude foreign corporations, impose local corporate rules on them, or otherwise condition their entry to do a local business.[252] State officials would understandably have wished to regulate foreign corporations whose acquisition of local plants and other productive assets might impede local competition. As Alton Adams noted in 1903:

> With ample power to refuse admission to foreign corporations . . . , a state may maintain production on a competitive basis within its limits. A foreign corporation owning plants of a particular character in other states may be denied the right to purchase such factories in any given state, or to continue in their ownership or operation there even after purchase. Or, if absolute exclusion

248. Steffens, *supra* note 229, at 51 (internal citations omitted).

249. *Id.*

250. *See* James B. Dill, *National Incorporation Laws for Trusts*, 11 YALE L.J. 273, 282 (1902) (describing New York legislative committee desire to compete with New Jersey in 1902); Keasbey, *supra* note 125, at 201-02 (describing competitive efforts of West Virginia, Kentucky, Delaware, and New York); Stoke, *supra* note 75, at 575-76 (additionally listing Maryland and Maine as competitors).

251. *See infra* Part V.D.

252. *See supra* notes 194-200 and accompanying text.

> seems too radical, a heavy special tax may be laid by any state on each foreign corporation owning mines, forests or factories . . . in other states. The result of such taxes would be to bring the mines, forests or factories rapidly back into the hands of independent operators.[253]

State officials could also readily have revoked the charters of domestic corporations attempting to merge or consolidate into New Jersey holding company structures. The same *quo warranto* actions that state attorneys general took against the trusts would have been viable after those same trusts found homes as holding companies under New Jersey's corporation law. Operating companies chartered in the various states had no more power to transfer control to New Jersey holding companies than they had to transfer control to the trusts that preceded them.[254] For the non-New Jersey corporations, such consolidations were *ultra vires* and subject therefore to the same vulnerabilities as the transactions by which they had attempted to join the trusts earlier.[255]

C. Lack of Resistance

Officials in most states did not resist. Instead, most copied the provisions of New Jersey law most attractive to the trusts and corporate promoters.[256] If state officials had the legal power to fight the new trusts—by regulating foreign corporations and revoking the charters of domestic corporations attempting to consolidate with foreign corporations—then why did they not?[257] Addressing this question also explains the

253. Alton D. Adams, *State Control of Trusts*, 18 POL. SCI. Q. 462, 478 (1903).

254. Such a transfer of control might take various transactional forms, all of which were generally restricted by state corporation laws before New Jersey's dramatic amendments. A simple merger into a New Jersey corporation was not generally authorized. Likewise, a sale of all the corporation's assets to a New Jersey corporation in exchange for the stock of the New Jersey corporation was held to be *ultra vires* under Michigan law. The selling corporation was not authorized to invest in the stock of another corporation, and its sale of its franchise was "contrary to a sound public policy." McCutcheon v. Merz Capsule Co., 71 F. 787, 792-94 (6th Cir. 1896); *see also* De La Vergne Refrigerating Mach. Co. v. German Sav. Inst., 175 U.S. 40, 54-58 (1899) (holding that New York corporation was not authorized to purchase stock of rival corporation).

255. *See supra* notes 221-224 and accompanying text. Besides precluding their domestic corporations from combining with New Jersey corporations, state officials would have wished to preclude their domestic corporations' alternative strategy of dissolving and reincorporating in New Jersey, while continuing to do a local business. *See* McCurdy, *supra* note 221, at 336. Excluding foreign corporations or imposing appropriate conditions on them would have foiled this end run around domestic corporation laws and precluded unwanted industrial concentration.

256. By 1913, almost all the states had done away with limits on capitalization and the requirement that stock must be paid for in money. *See* J. Newton Baker, *The Evil of Special Privilege*, 22 YALE L.J. 220, 222 (1913). Nine states even explicitly declared that absent fraud, the directors' judgment was conclusive as to the value of property for which stock was issued. *See id.* Perpetual charters for any lawful purpose became the general practice. Eighteen states explicitly permitted mergers and consolidations, and only two expressly prohibited it. Nineteen states permitted corporations to hold stock of other corporations; only two prohibited this, while it was qualified in seven states. Most states permitted corporate meetings to be held outside the state of incorporation and did not require that even one director be a resident of the incorporating state. *See id.*

Several states even offered *extraterritorial* charters—charters for the incorporation of firms to do business anywhere *except in the state of incorporation*. *See* Dill, *supra* note 250, at 283-86 (describing extraterritorial charter programs of Pennsylvania, New York, and Connecticut).

257. For example, a state could have selectively admitted foreign corporations to do business locally based on their structural features. Local competition might have been preserved if the only foreign corporations admitted to do business were those whose capitalization did not exceed local limits and whose shares were not

survival of the internal affairs doctrine despite the changed circumstances. Legislatures did not resist because collective action among states was difficult, and unilateral action by one state's officials was very risky both for the state economy and for the political fortunes of those officials. In-state interest groups emerged with concentrated stakes in continuing economic interaction with foreign corporations. Imposition of restrictive local rules on foreign corporations would have deterred this economic interaction. Federal and state officials also developed antitrust laws and other policy margins besides corporate law along which they could respond more selectively to the demands of particular groups for insulation from the economic dislocations of the merger movement. For state officials, these regulatory substitutes made local corporate law less important as a device for favoring local constituents or attempting to control local industrial organization. Regulatory substitution reduced local constituents' demands for restrictive corporate law and for imposition of local corporate rules on foreign corporations.

1. Difficulties of Collective Action and Risks of Unilateral Action

State officials considered coordinated action against the trusts.[258] For example, in September 1899, governors and attorneys general of nine states participated in the St. Louis Antitrust Conference,[259] which recommended a host of corporate law rules to prevent excessive industrial concentration, including the prohibition of holding companies and watered stock.[260] The conference resolved that each state should enact laws "for the adequate and proper control and regulation of corporations chartered in that state." As for foreign corporations, one conference recommendation directly challenged the internal affairs doctrine, calling for exclusion of foreign corporations except on equal terms with the domestic corporations of each state "and subject to the same laws, rules, and regulations of the state . . . which are applicable to domestic corporations of that state."[261]

However, it soon became apparent that coordinated state action was impossible. Too many legislatures pursued their own parochial interests in imitating New Jersey. By 1902—three short years after the St. Louis Antitrust Conference—the president of the Commissioners on Uniform State Laws admitted the futility of attempting adoption of a uniform incorporation act among the states. "The trend of legislation in too many of the States is to enact laws favoring incorporation with a view to the pecuniary returns to the State rather than with a view to adherrence [sic] to sound principles."[262]

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owned by another corporation.

One later commentator argued that states' power to exclude foreign corporations or admit them on conditions does not "extend so far as to give the legislatures of a state power to regulate or control the internal affairs of a foreign corporation." 8 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5807 (perm. ed., rev. vol. 2001). However, absent Constitutional constraint, it is hard to see what prevented a state from doing so. And as noted in the text, some have.

258. *See* McCurdy, *supra* note 221, at 338-41.

259. Michigan, Missouri, Texas, Arkansas, Colorado, Tennessee, Iowa, Indiana, and Montana were represented. *The St. Louis Anti-trust Conference*, 27 PUB. OPINION 387 (1899).

260. *See id.* On watered stock, see *infra* note 293 and accompanying text.

261. *The St. Louis Anti-trust Conference*, *supra* note 259. The resolution specifically excepted corporations engaged in interstate commerce. *Id.*

262. State Boards of Commissioners for Promoting Uniformity of Legislation in the United States, Report

Commerce Clause limitations on state regulatory authority likely exacerbated this collective action problem among state legislatures.[263] For interstate commerce, the states would have to rely on the federal government to regulate, and regulation of intrastate activity was up to each individual state. Not only would solidarity among forty-six jurisdictions—forty-five states plus the federal government—have been required, but an effective division of regulatory responsibilities between the federal government and the states along Commerce Clause lines would have been quite tricky to implement.[264]

Exacerbating the difficulty of collective action, officials in any individual state took great risks in attempting to curb the trusts unilaterally. While they could certainly drive the trusts from the state through *quo warranto* actions and a foreign corporation statute, this might cause enormous damage to the local economy. Once a domestic corporation was dissolved or a foreign corporation's license revoked because of trust affiliations, it was often unclear what would happen to the firm's local assets. Could other manager-investors keep the local plant open? Driving out trusts might have generated some short-term populist satisfaction, but this could not guarantee that local producers could survive

of Twelfth National Conference 7 (1902). Today this organization is known as NCCUSL, the National Conference of Commissioners on Uniform State Laws. *See* Uniform Law Commissioners, http://www.nccusl.org/Update/DesktopDefault.aspx? tabindex=0&tabid=11 (last visited July 21, 2004).

Besides the franchise taxes from domestic corporations, some states charged similar fees for foreign corporations based on their authorized capital. *See* MASSACHUSETTS REPORT, *supra* note 113, at 295-97. Excluding or deterring foreign corporations would have cost these states in fees, just as the dissolution of domestic corporations would have.

263. States found themselves with a classic collective action problem. *See generally* OLSON, *supra* note 174. Even if every other state took the "virtuous" path against New Jersey, each individual state stood to gain by defecting—that is, imitating New Jersey.

264. Ernest W. Huffcut, *Constitutional Aspects of the Federal Control of Corporations*, in 1 INDUSTRIAL COMMISSION REPORT, *supra* note 222, at 1211, 1213.

> Congress . . . could not suppress a monopoly for the manufacture of sugar, while the States could not suppress a monopoly for the interstate sale of sugar. The States could exclude the manufacturing corporations . . . [b]ut the States could not exclude the trading corporations, for the States can not regulate interstate commerce. If, then, the corporations are both manufacturing and trading corporations, how are they to be dealt with? . . . Forty-four States may pass uniform laws to control such combinations; the forty-fifth may render this combined action in large part nugatory by chartering and protecting the very combination which it is the object of the forty-four to suppress. In such case it would require a harmony of action among the States to prevent a monopolistic manufacturing combination and cooperative action on the part of the United States to prevent a monopolistic trading combination. In other words, forty-six distinct jurisdictions must work in concert in order to protect all the people of the United States from combinations formed to control the prices of raw material and the output and price of the finished products.

Id. Moreover, states tended to give a wide berth regarding regulatory issues that might run up against Commerce Clause problems.

> In yielding control of interstate commerce to the Federal Government there has been naturally some serious loss to the States in general governmental power, quite distinct from the mere inability to regulate commerce. In the desire to avoid the evils of separate and antagonistic control of trade and commerce the States have deprived themselves of the power to control their own internal affairs whenever those affairs are connected in any direct way with commerce between the States or with foreign nations.

Id. at 1211-12. Apparently, even if this monumental solidarity could have been maintained, Quebec stood ready to offer a safe haven for trust corporations! *Id.* at 1215.

as independent entities.[265]

Industry concentration was driven only in part by the private pursuit of monopoly; basic economic considerations also played an important part. The rise of integrated national markets created larger opportunities for firms, but also put more firms in competition with one another. As these firms expanded production in pursuit of these larger markets, excess capacity was the result. Especially for commodities and standardized products, overproduction caused falling prices, imperiling some firms. Horizontal combination was a natural corrective.[266] According to the Report of the U.S. Industrial Commission in 1900, "[a]mong the causes which have led to the formation of industrial combinations, . . . competition, so vigorous that profits of nearly all competing establishments were destroyed, is to be given first place."[267]

To the extent that achievement of scale economies was necessary for survival, a legislature that unilaterally impeded these combinations effectively condemned its local factories to ruin. The accompanying job losses and reduced tax base made such outcomes singularly undesirable. The mid-1890s was a period of severe depression. During the Panic of 1893, nearly 15,000 companies failed, 500 banks went into receivership, and nearly 30% of the nation's rail system was insolvent. Unemployment hovered around 18%, and for those with jobs, wages dropped by an average of almost 10%. This was not a good time for state officials to be discouraging local enterprise. McCurdy notes that "after 1895, the *quo warranto* mechanism, which had seemed so promising only five years earlier, fell into disuse."[268] In 1902, the Indiana attorney general reported the futility of unilateral action against the trusts, concluding that only federal regulation would suffice.

> No trust has been incorporated in Indiana under our law during the last four years. Foreign corporations have purchased individual plants in this state and are operating them in connection with their other plants, purchased elsewhere. The federal authorities are now engaged in a prosecution which will test to the limits the necessity of further legislation by congress [sic], or the necessity for a constitutional amendment which will enable congress [sic] to adequately regulate, or totally destroy, every form of trust or combination.
>
> It is apparent that control of combinations should be general in character, for, while one state might drive manufacturing concerns from its borders, it

265. McCurdy recounts several examples of state attorneys general's practical inability to reduce the local influence of Standard Oil. Driving Standard Oil affiliates out of state could not guarantee that local refining and distribution operations could be sustained as independent entities. Growing local demand for oil severely constrained state officials in their attempts either to fight collusion or place control of local assets in local hands. Charles W. McCurdy, 54 BUS. HIST. REV. 401 (1980) (reviewing BRUCE BRINGHURST, ANTITRUST AND THE OIL MONOPOLY: THE STANDARD OIL CASES, 1890-1911 (1979)).

266. *See* Alfred D. Chandler, Jr., *The Beginnings of "Big Business" in American Industry*, 33 BUS. HIST. REV. 1, 10 (1959).

267. 1 INDUSTRIAL COMMISSION REPORT, *supra* note 222, at 9.

268. McCurdy, *supra* note 221, at 339. Private challenges to *ultra vires* consolidations by minority shareholders, however, were consistently recognized, and mergers enjoined. Small v. Minneapolis Electro Matrix Co., 45 Minn. 264 (1891); Easun v. Buckeye Brewing Co., 51 F. 156 (C.C.N.D. Ohio 1892); Buckeye Marble and Freestone Co. v. Harvey, 92 Tenn. 115 (1892); Byrne v. Schuyler Elec. Mfg. Co., 65 Conn. 336 (1895); Forrester v. Boston & Mont. Consol. Copper and Silver Mining Co., 21 Mont. 544 (1898).

> would only result in closing down all domestic factories and the furnishing of the products thereof to the people of such state by the factories of a foreign state, where legislation was friendly to such combinations, as it now is in more than a half-dozen states of the Union.
>
> General laws and regulations for concerns that do a general business throughout the United States has [sic] come to be, by common consent, the only effective remedy available.[269]

2. Local Interest Group Influences

Even before the merger movement, once firms' operations began to spill over state lines, these firms naturally developed constituencies in various states that stood to benefit from the firms doing business locally.[270] With the merger movement, dramatic horizontal consolidation and vertical integration made interstate firms ubiquitous across important industries. Local employees now worked for foreign corporations. Local customers and suppliers had important relations with foreign corporations. Foreign corporations used local transportation and communication facilities. They might offer capital, managerial expertise, or scale economies that could keep the local plant in operation, when it would otherwise be shuttered. They might offer an interstate distribution system for locally produced goods. For economic and political purposes, whether the foreign corporation had significant economic ties to its state of incorporation now mattered little.

Local interest groups with high per capita stakes in continuing economic interaction with these foreign corporations could readily organize to assert their interests. Local managers and other employees of foreign-incorporated firms or affiliates of foreign holding companies, for example, would not have been shy about voicing their druthers to legislators. The same with local customers—especially industrial consumers—and suppliers. All would have had large stakes in the continued in-state activities of foreign corporations. Legislators protective of these stakes would enjoy the political support of these groups, as well as the political benefits from an increased tax base from these economic activities. With these pressures and inducements to support local interaction with foreign corporations, legislatures would have been hard pressed to maintain laws generally excluding foreign corporations or significantly deterring their entry. States' territorial monopolies on corporate law appeared unsalvageable.

Reluctance to demand conditions for entry likely precluded any thought of regulating foreign corporations' internal affairs. The corporate law rules at issue during that period had been fundamental regulatory tools, meant to regulate local industrial organization for the benefit primarily of local producers and investors, as well as for rent-seeking legislators.[271] Corporate longevity and capitalization limits, the scope of

269. 1900-1902 IND. ATT'Y GEN. BIENNIAL REP., at 24-25.

270. *See* Bruce H. Kobayashi & Larry E. Ribstein, *Contract and Jurisdictional Freedom*, *in* THE FALL AND RISE OF FREEDOM OF CONTRACT 325, 333 (F.H. Buckley ed., 1999); Carney, *supra* note 16, at 313. The firms themselves were influential in local politics, contributing to both political parties. JEREMIAH W. JENKS, THE TRUST PROBLEM 192 (rev. ed. 1903). The large conglomerates were rumored to exercise inordinate sway over local legislatures. *Id.* at 190.

271. *See supra* Part IV.B.2.

corporate purposes, authorization for mergers and corporate stock holdings, and the prospect of unlimited liability in some circumstances, were all up for debate. Legislatures were ready to concede these most critical issues concerning corporations' internal organization in order to retain the incorporation of their own local firms and to avoid deterring foreign corporations whose entry might boost their ailing economies. Any contemplated application of local corporate rules to a foreign corporation would likely have been triggered based on certain local contacts or activities of the foreign corporation. But regulating the internal affairs of foreign corporations on this basis would have caused some foreign corporations simply to avoid those sorts of local contacts[272]—contacts that were presumably desirable to well-organized local interests.

Especially in the immediate aftermath of the merger movement, potential incursions on the internal affairs doctrine would have enjoyed only weak political support. Local producers could not be helped by state officials' attempts to curb foreign competition. Returns to scale and the rise of multistate firms and powerful monopolies in numerous industries made control of local industrial organization impossible for state officials. Even driving out foreign corporations with traditional structural regulation would therefore not have helped local producers survive.[273] Local investors in foreign corporations might have wished for application of protective local corporate law by local courts for disputes over internal affairs, but these benefits would have been difficult to anticipate ex ante. The intricacies of jurisdictional rules for corporate law would likely not have been salient to local investors, who might come to learn of these rules only in the event of a dispute. At least in the early part of the twentieth century, these investors likely comprised only a fairly small group in any state, so that a critical mass of disgruntled investors would have been unlikely to form.[274]

Especially given the general trend of liberalized corporate law, there were likely fewer and fewer important protections in local corporate law that local producers or investors would have found useful. Provisions facilitating industrial consolidation and less constraining to management were copied; provisions with the opposite bent were rebuffed. For example, New Jersey's amendments to facilitate corporate acquisitions included a provision shielding directors' business judgment concerning the value of property acquired for stock.[275] This was a dramatic liberalization in the rules of internal corporate management. In contrast, as discussed below, New York attempted to impose certain personal liabilities on directors, officers, and stockholders of foreign corporations—a fairly aggressive incursion on internal affairs.[276] But while New York's

272. The Connecticut legislature had earlier apparently learned a hard lesson in this regard. An 1881 amendment to its corporation statute to require that a majority of directors be residents and that twenty percent of a corporation's capital stock be paid in cash succeeded in "[driving] from her borders not only foreign enterprises but also her own industries." COOK, *supra* note 197, § 935.

273. *See supra* note 265 and accompanying text.

274. The exceptional case might have been New York. Significant public ownership of stock—separating ownership from control—likely occurred there before it spread to other states. This may explain New York's singular early attempt to protect local investors in disregard of the internal affairs doctrine just on the heels of the merger movement. *See supra* Part V.C.2. Ironically, New York later lagged behind other states in enacting blue sky laws. As of 1920, it was apparently a center for stock promotion. William W. Cook, *"Watered Stock"—Commissions—"Blue Sky Laws"—Stock Without Par Value*, 19 MICH. L. REV. 583, 591 (1921).

275. *See supra* note 233 and accompanying text.

276. *See infra* notes 310-317 and accompanying text.

regulatory amendment was rebuffed,[277] New Jersey's liberalizing provision was quickly copied, even by New York. By 1903, six other states including New York had adopted provisions giving conclusive effect to directors' judgment on the valuation of property taken as payment for stock.[278]

In addition, managers' increasing power within firms probably also enabled them to be more effective lobbyists than shareholders. From the early part of the twentieth century, power within the corporation began to shift from shareholders to directors.[279] As late as 1896, the U.S. Supreme Court declared that absent some indication otherwise, managerial authority rested ultimately with stockholders.[280] However, after the merger movement, as ownership separated from control and investors diversified their investments over a growing array of publicly traded companies, a class of passive investors arose. It became more and more difficult to ascribe ultimate managerial authority to so large and amorphous a group.[281] As power within firms shifted from shareholders to directors, and as securities markets emerged to offer diversification and liquidity to shareholders, shareholder exit became a more attractive option than voice.[282] Widely dispersed and increasingly anonymous shareholders could sell, rather than fight with management.

Having given up the fight to regulate with corporate law during the heyday of the merger movement, state legislatures would generally have seen increasing and increasingly important commercial contacts with foreign corporations. With that trend firmly in place, legislators and interest groups in each state would generally have seen no point to opposing recognition of foreign corporations and respect for foreign corporation law.[283] Therefore, the extant internal affairs doctrine never came up for revision. By their inaction, state legislatures acquiesced in letting firms choose.

3. Regulatory Substitution

Responding to the flaccidity of corporate law as a rent-seeking and regulatory tool, both Congress and state legislatures made adjustments along other policy margins to answer the demands of interest groups previously protected by the traditional structural restrictions in corporate law. In effect, legislatures developed substitutes for corporate law in order to continue providing protection for favored local interests from the depredations of economic competition. For example, Congress passed the Sherman Act to fight the trusts at the national level, in large measure at the behest of small businesses and farmers fearing "the ravages of excessive competition."[284] State legislatures devised

277. *See infra* notes 320-325 and accompanying text.

278. The six states were Connecticut, Delaware, Maine, New Jersey, North Carolina, and West Virginia. MASSACHUSETTS REPORT, *supra* note 113, at 181.

279. *See* MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW 1870-1960: THE CRISIS OF LEGAL ORTHODOXY 98 (1992) (explaining shift of power away from shareholders).

280. Union Pac. Ry. Co. v. Chi., Rock Island. & Pac. Ry. Co., 163 U.S. 564, 596 (1896).

281. *See* HOWARD HILTON SPELLMAN, A TREATISE ON THE PRINCIPLES OF LAW GOVERNING CORPORATE DIRECTORS 4-5 (1931) (describing absolutism in management of large corporations).

282. *See* ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1972).

283. Ironically, New Jersey was the only state to backtrack for a crucial few years. *See supra* note 32.

284. Herbert Hovenkamp, *The Robinson-Patman Act and Competition: Unfinished Business*, 68

state antitrust laws and other types of territorial regulation to protect particular local producers and trade groups. While territorial monopolies on corporate law could no longer be maintained, and general imposition of local corporate law on foreign corporations became unworkable, state legislatures could still target territorial regulation or impositions more specifically. And, of course, Congress could act on a national scale. This regulatory substitution would have helped to minimize any political pressure for revision of the internal affairs doctrine. Here, I focus on state legislatures' policy adjustments.

a. Influencing local industrial and labor organization

State legislatures devised new territorial regulation to affect local industrial and labor organization after corporate law became unusable in this regard. State antitrust laws offer the most immediate example of this sort of regulatory substitution. These laws came almost simultaneously with the corporate law liberalization that eliminated structural limitations states had relied upon to regulate local market structure. Without the ability to prohibit holding company structures or limit the capitalization of corporations doing local business, state legislatures could at least retain some influence over the structure of specific local markets through antitrust laws. These statutes enabled them to respond to the protectionist demands of local producers,[285] as well as the popular fear of monopoly power.[286] By 1914, all but seven of the forty-eight states had constitutional or statutory prohibitions against trusts.[287] Reminiscent of the market structure regulation built into earlier state corporation laws, many state antitrust statutes exempted favored groups like labor and agricultural associations.[288]

Similarly, the artisans and small entrepreneurs that were once protected from larger businesses through the structural limitations in corporate law now lost out to the integrated firms. Local industrial labor relations became an important and politically charged issue. Whether state officials favored firms or labor, liberalized corporate law could no longer influence firm size. If workers were to be protected, they had to be protected in other more direct ways. Toward the end of the nineteenth century, state legislatures addressed these issues directly through their labor laws.[289] One common

ANTITRUST L.J. 125, 130 (2000); *see also* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE 47-51 (2d ed. 1999) (addressing purposes and criticisms of the Sherman Act).

285. Daniel A. Farber & Brett H. McDonnell, *Why (and How) Fairness Matters at the IP/Antitrust Interface*, 87 MINN. L. REV. 1817, 1835 (2003).

> Whatever one thinks about the relative weight of the various goals stated as justifications for antitrust laws, small producers organizing to protect themselves against new big businesses at the turn of the century were critical to those laws gaining political support. Thus, rent-seeking behavior was an important part of the origins of the antitrust laws.

Id.

286. *See* James May, *Antitrust in the Formative Era: Political and Economic Theory in Constitutional and Antitrust Analysis, 1880-1918*, 50 OHIO ST. L.J. 257, 348-61 (1989) (describing state judges' attempts to reconcile desire for economic growth with firms' anticompetitive behavior).

287. JENKS & CLARK, *supra* note 207, at 216.

288. *See id.*

289. *See* Lawrence M. Friedman, *Freedom of Contract and Occupational Licensing 1890-1910: A Legal and Social Study*, 53 CAL. L. REV. 487, 489-94 (1965) (describing passage of labor legislation by state

enactment, for example, mandated the frequency of employee wage payments.[290]

Related to these general labor statutes, legislatures responded to particular powerful professional and trade unions with protection in the form of occupational licensing systems. The favored trades and professions basically defined their own licensing standards, enabling them to control the supply of sanctioned specialists. These arrangements flourished beginning in the late nineteenth century.[291] From doctors to plumbers and barbers and blacksmiths, legislatures succumbed to organized pressure for economic protection.[292]

b. Shareholder protection: Blue Sky laws

For local investors as well, legislatures devised new territorially-based regulation to offer some protection that corporate law could no longer offer. As stock offerings became larger and more widespread, promoter fraud became common. A particular problem for new investors was the practice of stock watering by promoters who had incorporated under some state's lax corporation laws. To water stock,[293] promoters inflated the value of property they sold to the corporation in exchange for its stock, before selling more of the corporation's shares to outside investors. These investors effectively overpaid for their stock. They paid 100-cent dollars in cash for their stock; the promoter paid far less. As a result, outside investors were deceived as to the strength of the company's capitalization and asset values.

State legislatures created blue sky laws to address this popular fraud. Corporate law was no longer useful for this purpose because of the new dynamics of state competition.[294] Beginning with Kansas in 1911, states established securities commissions to review the merits of offerings before they could be made to local investors.[295] The Kansas statute required registration of securities and securities salesmen. Only securities

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legislatures).

290. *See id.* at 489. Wisconsin was even willing to burden corporate shareholders with labor obligations. Since the 1850s, a Wisconsin statute imposed liability on shareholders for corporate debts for employee labor claims. In 1878, Wisconsin modified the statute to apply to shareholders of foreign corporations as well. Joncas v. Krueger, 61 Wis. 2d 529 (1974).

291. *See* MORTON KELLER, AFFAIRS OF STATE: PUBLIC LIFE IN LATE NINETEENTH CENTURY AMERICA 411 (2000) (describing involvement of various trades and professions in occupational licensing and other forms of regulation).

292. *See* Friedman, *supra* note 289.

293. Commentators offer various theories for the origin of the term "watered stock." Some suggest it originally described the practice of dairymen of watering down their milk in order to increase their profits. Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 356 n.37 (1991). Others believe it originated with the practice of unscrupulous cattle drovers who induced their cows to drink large amounts of water just before bringing them to market. Their increased weight increased their selling price. "[The] stock was, quite literally, watered." Lawrence E. Mitchell, *Squeezing Truth from Power: The Rise of American Corporate Capitalism*, ch. 3, at 7 (George Washington University Law Sch. Pub. Law & Legal Theory Working Paper, No. 197, 2006), *available at* http://ssrn.com/abstract=887397. In any event, men with cows seem to be the original culprits.

294. *See* Cook, *supra* note 274, at 589; ALFRED F. CONARD, CORPORATIONS IN PERSPECTIVE 18-19 (1976) (describing silence of corporate laws with respect to investor protection).

295. Precursors included statutes regulating stock subscriptions in particular industries. LOUIS LOSS & EDWARD M. COWETT, BLUE SKY LAW 3-5 (1958) (describing 1852 Massachusetts statute requiring paid-in capital for railroad companies and state regulation of securities issuance by public utilities).

that received the blessing of the commission could be sold to the public, and the commission enjoyed a broad scope of review. Grounds for prohibiting an offering included a finding that any of the issuer's organizational documents or business plan contained any "unfair, unjust, inequitable or oppressive" provision, or that the issuer "does not intend to do a fair and honest business," or "does not promise a fair return on the stocks, bonds or other securities."[296] Within two years of Kansas' enactment, twenty-three other states had followed suit. Almost all these later enactments were patterned after the Kansas model.[297] Shareholder protection may not have been the sole motive for these enactments,[298] but the statutes' protections would naturally have relieved legislatures from attempting to regulate through their corporation laws, a strategy that would have required revision of the internal affairs doctrine.

* * *In general, state legislatures did not revisit the extant internal affairs doctrine or attempt to frustrate charter competition with imposition of local corporate rules on foreign corporations. Collective action problems and the influence of local interests with economic ties to foreign corporations deterred legislatures from resisting competition. Instead, legislatures developed other regulatory tools to satisfy local demands for economic protection.

D. Internal Affairs Warfare: New York and New Jersey, 1897

While other states generally acquiesced to corporate charter competition, New York resisted for a time. Disregarding the internal affairs doctrine, it passed legislation imposing local corporate rules on foreign corporations. From early on in the merger movement, New York had recognized New Jersey's threat to New York incorporations and taxation.[299] Special legislative committees were formed in 1888, 1891, and 1897 to study the trust problem that New Jersey had created and to recommend remedial legislation.[300] The 1891 committee report recounted the egregious example of the reincorporation of the Sugar Trust to New Jersey immediately following the New York attorney general's successful action to dissolve the trust in New York.[301] The new New Jersey entity continued doing business in New York as before.[302] To add insult to injury,

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296. *Id.* at 8 n.24 (citation omitted).

297. *Id.* at 10.

298. Macey & Miller, *supra* note 293 (describing political support of banks, bank regulators, and prospective borrowers, who saw securities investments as competition for depositor funds).

299. As early as 1894, New Jersey's charter mongering strategy enabled it to "run[] the state government very largely on the revenues derived from New York enterprises." COOK, *supra* note 197, § 935.

300. *See* NEW YORK 1888 REPORT, *supra* note 211; NEW YORK 1891 REPORT, *supra* note 213; Report and Proceedings of the Joint Committee of the Senate and Assembly, Appointed to Investigate Trusts, N.Y. Sen. Doc. No. 40 (1897) [hereinafter New York 1897 Report].

301. Eight New York corporations were members of the trust. Following the New York state attorney general's successful action against these corporations, all the constituent corporations of the trust transferred their property to a newly formed New Jersey corporation. NEW YORK 1891 REPORT, *supra* note 213, at 5, 10.

302.

> [W]e find the Sugar Refineries Company or trust in this State declared to be unlawful by the highest court of the State, and then we witness the bold spectacle of the same combination practically going to an adjoining State and there organizing a new company under a new name, but practically for the same purpose, . . . and then the new company establishes itself in the same offices in the city of New York, and goes on with its same business and practically the same

the new corporation's officers removed the books and records of the trust's former constituent entities to New Jersey in likely anticipation of New York's legislative investigation. The officers refused to produce the books even under subpoena from the New York legislature.[303] The 1891 report acknowledged New Jersey's favorable environment for trusts, including its more favorable corporation laws that allowed a corporation to hold stock in other corporations.[304] The report noted the New Jersey incorporation of several companies "who transact their business in New York, chiefly if not entirely."[305]

New York's early response, however, was mixed. While the 1891 report recommended aggressive measures against the trusts,[306] an 1892 corporate law revision permitted corporations to acquire the stock of other corporations, thereby enabling holding company structures.[307] That same year, the governor of New York approved a special charter for the General Electric Company, with terms based on New Jersey's general corporation act, explicitly to head off the company's reincorporation in New Jersey.[308] Earlier in 1890, New York had also eliminated its limits on authorized capital, also in response to the migration of New York firms to New Jersey for their corporate charters.[309]

Finally, in 1897, New York's legislature took direct aim at New Jersey corporations, with an approach more nuanced than simply imposing structural requirements on foreign corporations. Instead, New York sought to affect New Jersey corporations' internal affairs by imposing "all requirements of the local law especially designed for the protection of creditors and shareholders,"[310] in complete disregard of the internal affairs doctrine. This enactment subjected officers, directors, and stockholders of foreign corporations transacting business in New York to personal liability, under the same rules applicable to domestic corporations, for (i) unauthorized dividends, (ii) unauthorized and excessive indebtedness, (iii) unlawful loans to stockholders, (iv) false certificates, reports, or public notices, (v) illegal transfers of stock and property "when the corporation is

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> combination.

Id. at 13.

303. *Id.* at 12.

304.

> There is cause to believe that the persons who organized the new sugar trust and incorporated the same under the laws of the State of New Jersey, did so to escape the rigors of our laws in several particulars: (1) to escape taxation under the laws of this State; (2) under the laws of New Jersey the company could issue common and preferred stock, which could not be done in New York; and, (3) under the laws of New Jersey the new company could hold and own the stock of other companies, domestic or foreign, without restriction.

Id. at 12-13.

305. *Id.* at 13.

306. The report recommended, among other things, that foreign corporations doing business in New York be taxed in New York, and that trust corporations organized out-of-state be required to keep their books and records in-state. NEW YORK 1891 REPORT, *supra* note 213, at 13-14.

307. N.Y. LAWS 1892, at 90; NEW YORK 1897 REPORT, *supra* note 300, at 6.

308. HENN, *supra* note 144, at 18; Liggett Co. v. Lee, 288 U.S. 517, 562 n.41 (1933) (citation omitted) (Brandeis, J., dissenting).

309. *Liggett*, 288 U.S. at 560-61 (citing N.Y. BUS. CORP. L. ch. 567, § 12. (1890)).

310. NEW YORK 1897 REPORT, *supra* note 300, at 36.

insolvent or its insolvency is threatened," and (vi) failure to file an annual report.[311]

By the time of this enactment, it was clear that New Jersey incorporation was a popular device for large firms doing business in New York to avoid New York regulation and taxation.[312] The 1897 legislative committee report confirmed a general trend of migration to New Jersey incorporation by firms with no business in New Jersey but with substantial business in New York, in order "to relieve the corporation . . . of some duty or obligation which would have rested upon it had it been organized under the laws of this State."[313] As a consequence, "although for all practical purposes a corporation of this State, operating here, receiving the protection of our laws, and the opportunities of our markets," such a corporation "is permitted by a mere fiction to escape duties and obligations imposed on corporations similarly situated but created in our own State."[314]

The committee rejected the idea that New York should compete with New Jersey to "traffick[ ]" in "colorable [charters]."[315] Instead, it attempted to deter the foreign incorporation of New York businesses and to remedy any disadvantage to domestic corporations from New York's more stringent corporate law rules.[316] With its 1897 enactment, "New York attempted forcibly to domesticate foreign companies under penalty of practical withdrawal of the corporate shield of protection of stockholders and officers, imposing a contract liability on stockholders and directors."[317]

New York's special endowments help explain its unilateral gambit against New Jersey's chartermongering strategy. With New York being home to Wall Street and the

311. 1897 N.Y. Laws 315; *see also* Historical Note, N.Y. STOCK CORP. L. § 114 (McKinney 1940). The "transacting business" requirement meant to target corporations with all or substantially all of their business in New York. NEW YORK 1897 REPORT, *supra* note 300. [need pincite] The same enactment required each foreign corporation doing business within the state to file an annual report detailing its capital stock, its debt, and its assets, and to keep its stock book in the state and available for inspection by stockholders and judgment creditors, as well as state officers. 1897 N.Y. Laws 313-14.

Personal liability of officers, directors, and shareholders to the corporation and its creditors falls squarely within the traditional understanding of internal affairs. *See supra* note 18 and accompanying text; *see also* Erickson v. Nesmith, 86 Mass. 233 (1862) (finding no jurisdiction over suit by creditor of New Hampshire corporation against stockholders); Halsey v. McLean, 94 Mass. 438 (1866) (following *Erickson* as to creditor of New York corporation). A few modern cases, however, have applied forum law to veil piercing cases. *See* Johnson, *supra* note 20, at 273 n.91. Hansmann and Kraakman suggest that choice of law rules should distinguish the corporation's tort creditors from its contract creditors for purposes of assigning personal liability to shareholders, with the internal affairs doctrine applicable only to contract creditors. Henry Hansmann & Reinier Kraakman, *A Procedural Focus on Unlimited Shareholder Liability*, 106 HARV. L. REV. 446, 450-51 (1992).

312. NEW YORK 1897 REPORT, *supra* note 300, at 22; William T. Coleman, *Corporate Dividends and the Conflict of Laws*, 63 HARV. L. REV. 433, 447 (1950).

313. NEW YORK 1897 REPORT, *supra* note 300, at 22.

314. *Id.*

315. *Id.*

316. One particular high court decision caused some legislative anxiety regarding potential competitive disadvantages for New York corporations. The Court of Appeals in *Vanderpoel v. Gorman*, 140 N.Y. 563 (1894), held that New York's prohibition on transfers and assignments by corporations in contemplation of insolvency did not apply to foreign corporations. A New Jersey corporation's assignment for the benefit of creditors—permissible under New Jersey's corporation law—was therefore validated. The New York legislature felt that this decision would disadvantage domestic corporations relative to their foreign competitors doing business in New York. *See* Irving Trust Co. v. Md. Cas. Co., 83 F.2d 168, 170 (2d Cir. 1936).

317. Dill, *supra* note 250, at 285.

center of corporate finance, the legislature would have been especially solicitous to the demands of commercial lenders and investment houses for protection from the financial shenanigans of wayward corporate managers of foreign corporations. Special protections for local creditors and investors against illegal loans, unauthorized indebtedness, unauthorized dividends, and the like by foreign corporations are not surprising. With its own robust state economy, the New York legislature also enjoyed a luxury unavailable to other state legislatures: it did not fear driving foreign corporations out of the jurisdiction. Given its sheer size and large internal market—it was the most populous state at the end of the nineteenth century by a large margin[318]—firms in many industries could not afford not to have a place of business in New York. Though the Commerce Clause protected out-of-state goods from discrimination, the costs of transportation and communication would have made it prohibitively expensive to try to supply the entire New York market from out-of-state.[319]

New York's gambit was short-lived, however. New Jersey swiftly retaliated. It had already passed a retaliatory reciprocity law in 1894 promising to impose, against the foreign corporations of any other state doing business in New Jersey, the same taxes, penalties, and other obligations imposed by that other state on New Jersey corporations.[320] This time, in response to New York in 1897, the New Jersey legislature enacted a law barring actions in New Jersey to enforce any statutory personal liability imposed by any other state on stockholders, officers, or directors of any New Jersey corporation for obligations of the corporation.[321] The bill was drafted, introduced into the legislature, and signed into law by the governor all in short order—forty-eight hours from start to finish.[322] New Jersey's corporation trust companies veritably crowed to prospective charter applicants about the state's responsiveness. Two companies actively advertised this aggressive retaliation in an identical circular:

> May we not refer to this as an instance of the watchful care which the N.J. Corporation Guarantee & Trust Co. (ditto the Corporation Trust Co. of N.J.) exercises over the corporations located with it when we say that this act, the importance of which cannot be overestimated, was drawn by our counsel, was introduced at 8:30 P.M. of March 29, and by 2:30 P.M. the following day was

318. New York's population in 1900 was close to 7.3 million. Pennsylvania was second, with a million fewer people, and Illinois was a distant third with only 4.8 million. 1 HISTORICAL STATISTICS OF THE UNITED STATES 1-227, 1-306, 1-327 (Susan B. Carter et al. eds., Millenial Ed. 2006).

319. *See* Carney, *supra* note 16, at 312-14 (noting that only states with large internal markets and large numbers of local corporations would attempt to regulate internal affairs of foreign corporations).

320. Liggett Co. v. Lee, 288 U.S. 517, 563 n.44 (1933) (Brandeis, J., dissenting) (citing 1894 N.J. Laws 347); 1 INDUSTRIAL COMMISSION REPORT, *supra* note 222, at 1085 (testimony of Mr. James B. Dill); Grandy, *supra* note 113, at 681 (citation omitted); *see also* Tex. Co. v. Dickinson, 75 A. 803 (N.J. Sup. Ct.. 1910) (holding that a Texas corporation was not entitled to a certificate of authorization to do business in New Jersey for failure to pay a $12,040 license fee calculated based on the amount of fee Texas would impose on a like New Jersey corporation); Babe Kaufman Music Corp. v. Mandia, 13 A.2d 790 (N.J. Ch. 1940) (precluding a New York corporation from bringing suit in New Jersey on a contract made in New Jersey prior to obtaining authorization to do business in New Jersey, on the basis that New York law would impose same penalty on a similarly situated New Jersey corporation doing business in New York).

321. 1897 N.J. Laws 124.

322. Dill, *supra* note 250, at 285.

> signed by the governor and became a law?[323]

According to Dill, that enactment essentially nullified any effect of the New York law.[324] New York effected further liberalization of its corporation law in 1901.[325]

E. Institutional Inertia

State legislatures ultimately did not fight to preserve territorial corporate law, and they left undisturbed the then-existing internal affairs doctrine. In the meantime, courts continued to conceive of corporations in territorial terms, echoing state sovereignty considerations from the eighteenth century. Courts referenced the sovereign powers of the incorporating state in refusing jurisdiction over disputes involving the internal affairs of foreign corporations. For example, an 1894 Minnesota Supreme Court decision noted:

> The doctrine is well settled that courts will not exercise visitorial powers over foreign corporations, or interfere with the management of their internal affairs. Such matters must be settled by the courts of the state creating the corporation. This rule rests upon a broader and deeper foundation than the mere want of jurisdiction in the ordinary sense of that word. It involves the extent of the authority of the state (from which its courts derive all their powers) over foreign corporations.[326]

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323. Steffens, *supra* note 229, at 50 (internal citations omitted).

324. Dill, *supra* note 250, at 285. In one famous case, however, directors of a New Jersey corporation were held personally liable to their corporation for unlawful dividends under the New York statute. *See* German-Am. Coffee Co. v. Diehl, 216 N.Y. 57 (1915). The corporation subsequently recovered. German-Am. Coffee Co. v. O'Neil, 102 Misc. 165 (N.Y. Sup. Ct. 1918).

325. *See* Liggett Co. v. Lee, 288 U.S. 517, 563 (1933) (Brandeis, J., dissenting) (citing N.Y. Laws 1901, chs. 355, 520).

326. Guilford v. W. Union Tel. Co., 61 N.W. 324, 325 (Minn. 1894). Despite this acknowledged limitation on the court's jurisdiction, however, it proceeded to order the corporation's issuance of replacement stock certificates to an in-state shareholder, finding that this would not interfere with internal management of corporate affairs. *See also* Clark v. Mut. Reserve Fund Life Ass'n, 14 App. D.C. 154 (D.C. Cir. 1899).

> [A]cts [authorizing local business by foreign insurance companies] do not extend the jurisdiction of the courts of one State and authorize them to reach over their territorial limits into the jurisdiction of another State, and to bring into review and revision the corporate acts and internal affairs of the local corporations of the latter State. Such a power, if attempted to be exercised, would be futile and ridiculous. Indeed, neither the legislatures of the States, nor the Congress of the United States, could confer such power.

Id. at 177.

Similarly, in 1897, the Supreme Court of Pennsylvania affirmed a dismissal of an action by shareholders of an electric utility company against the management for breach of fiduciary duty. The shareholders were Pennsylvania residents, and the corporation's major business was apparently the supply of electricity to the city of Philadelphia, but the company was incorporated in New Jersey. Madden v. Penn Elec. Light Co., 37 A. 817 (Penn. 1897). In affirming the dismissal, the court noted that plaintiffs' prayer for relief would require "corporate management of a foreign corporation" by the Pennsylvania courts. *Id.* at 818. But the corporation was "a New Jersey corporation, created by another state, and subject to the corporation laws of that state." *Id.* at 817. The Pennsylvania courts would not intervene even for a Pennsylvania resident "to protect him from the consequences of a voluntary membership in a foreign corporation. By the very act of membership, he intrusted his money to the control of an organization owing its existence to, and governed by, the laws of another state." *Id.* at 818.

In 1910, a Pennsylvania court sustained a demurrer in an internal affairs dispute involving a New Jersey corporation, in part because the action would require "the aid of a chancellor of this state to inquire into the internal management of a foreign corporation, and to make a decree in derogation of the sovereign power of the state of New Jersey, which state alone may investigate charges of the character here presented . . . ."[327] Similarly, in 1910 a New Jersey court noted the affront to a sister state that would result from taking jurisdiction over an internal dispute of a foreign corporation. Such a move would constitute "the usurpation by one state of the power of another over its own institutions."[328] In enunciating the jurisdictional rule, courts readily recognized states' lack of power regarding such disputes.[329]

The existing tradition of deference to the law and courts of the firm's state of incorporation was effortlessly followed, though the context and consequences had changed quite dramatically from the days of state territorial monopoly in which the internal affairs doctrine had originated.

VI. CONCLUSION

Here, I summarize the solution to the puzzle of the internal affairs doctrine. I then explore the implications of my analysis, offering a few preliminary lessons that this history of the internal affairs doctrine may teach us regarding the promise and prospects of strong-form regulatory competition generally.

The existence of the internal affairs doctrine seems puzzling when viewed as a snapshot—an equilibrium captured in a moment in time. It becomes less puzzling, however, when viewed as part of a history, involving a series of separate but related episodes. The piecemeal development of the doctrine and then state charter competition illustrates how a market for regulation may emerge, despite the seeming downside for rent-seeking lawmakers. In the face of court decisions espousing the internal affairs doctrine, legislators' consistent inaction was rational, albeit for different reasons at different times. The context for corporate law changed dramatically from the time of the doctrine's first articulation to its later employ as a rule facilitating state competition. At each phase, legislators concerned with their own private interests had ample reason to accept the doctrine as articulated.

Courts' application of the internal affairs doctrine could honor firms' choice of corporate law only when firms *had some choice* about where to incorporate. Firms had such a choice only *after* (a) incorporating states became willing to grant charters to firms without regard to any territorial tie, and (b) host states became willing to recognize foreign corporations' status and allow them to do business in-state—again without regard

327. Happersett v. Eaton, 38 Pa. C.C. 2, 5 (Pa. Com. Pl. 1910). The shareholder action involved accusations of unlawful dividends and unlawful asset transfers without shareholder consent.

328. Jackson v. Hooper, 76 N.J. Eq. 592, 606 (1910).

329. *See In re* Fryeburg Water Co., 79 N.H. 123 (1919) (finding that state public service commission lacked jurisdiction to approve stock issuance by foreign water company); Sierras Power Co. v. R.R. Comm'n of Cal., 205 Cal. 479 (1928) (holding railroad commission has no jurisdiction to issue permit to foreign electrical power company regarding issuance of stock); *cf.* Kimball v. St. Louis & S.F. Ry. Co., 157 Mass. 7 (1892) (finding that while court had jurisdiction over suit by shareholder to enjoin foreign corporation from issuing certain bonds, it would be "misuse" of powers to adjudicate suit).

to whether they had economic ties to the incorporating state. Only under these conditions could the internal affairs doctrine operate to facilitate competition. But at the initial articulation of the doctrine, these conditions did not hold.

Originally, the doctrine *protected* legislatures' monopolies on corporate law. When the doctrine first emerged in the 1860s, serving to defend states' sovereignty over their corporate creatures, state legislatures would have had no cause to complain, but would have expected the result and cheered the doctrine's articulation. The doctrine's deference to the incorporating state merely confirmed states' existing corporate law monopolies. With territorial corporate law, the doctrine *precluded* competition. It thus cemented corporations' dependence on the legislative grace of their home state legislatures.

Over time, however, the context for corporation law changed dramatically. Industrialization created economic conditions favoring large-scale firms in major industries. New Jersey's corporate law innovations during the great merger movement responded to the legal needs of these large-scale firms, leading to the demise of territoriality in corporate law—the rending of territorial ties between firms and their incorporating states. Tramp corporations emerged, sporting charters from states with which they enjoyed no substantive ties. The great trusts re-formed themselves as New Jersey corporations. States generally recognized the corporate status of these colossal tramp corporations and encouraged their conduct of local business activity. It would have been economically imprudent for most states, and politically disastrous for state legislators, to oppose their local presence or condition their entry. Too many local interests depended on the continuing local economic activity of these foreign corporations at the turn of the twentieth century. Moreover, only collective action among state legislatures—a cartel, in effect—could preserve the rents from state corporate law, and barriers to collective action were high.

Along with these strategic economic considerations, general liberalization of state corporation laws meant that imposition of local corporate law on foreign corporations would have offered little by way of added protection for local investors or producers. Legislators would therefore have had little to gain from such a strategy. Revisiting the internal affairs doctrine would have been an unattractive prospect for rational legislators.

Although conditions had changed—now firms could choose their incorporating state—the internal affairs doctrine and its notion of deference to the incorporating state remained unchanged. Originally a rule of deference to states' territorial monopolies on corporate law, in its new context, the internal affairs doctrine became a rule respecting private choice and enabling competition.

This history of the internal affairs doctrine may hold lessons for regulatory competition generally. Proposals for strong-form law-as-a-product competition abound in other areas of regulation.[330] These proposals attempt in some measure to generalize the

330. *E.g.*, Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998) (proposing that international issuers be allowed to choose their securities law); Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT'L L. 1 (1997) (arguing for private choice of insolvency law for transnational insolvency); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation,* 107 YALE L.J. 2359 (1998) (proposing that U.S. states be allowed to offer securities regulatory regimes to compete with federal securities law for issuers in U.S.); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES IN LAW 387 (2001) (advocating issuer choice in international securities regulation);

corporate charter competition model. But the historical contingency behind the internal affairs doctrine and resulting charter competition casts doubt that this model may be easily replicated. The role of the internal affairs doctrine in facilitating charter competition was not planned, and it was not inevitable. For proposed competition in other areas, the path to facilitative choice of law—and the path of institutional evolution more generally—is unclear and has generally remained unspecified.[331]

Timing and sequencing matter. The internal affairs doctrine actually *preceded* strong-form charter competition, and the doctrine emerged in a wholly different context. Other important conditions were also in place before strong-form competition could emerge. Earlier Commerce Clause decisions had severely curtailed states' ability to discriminate against out-of-state products.[332] The resulting national product markets had two important impacts. First, they enhanced firms' geographical mobility. A firm might locate operations to avoid a state's unfavorable regulatory climate without losing access to that state's product markets. Second, national product markets begat dramatic industrial consolidation and the formation of massive interstate firms. These enormous firms played a key role in enabling competition. While these firms needed New Jersey in the 1890s, New Jersey probably needed these great conglomerates as well. There could have been no more effective ambassador for acceptance of New Jersey tramp corporations.

At the outset, there was significant legal uncertainty as to how the new tramp corporations would be treated in the states in which they conducted business. Some courts and commentators deemed tramp incorporation to involve a dual fraud.

> To obtain a charter for the purpose of evading the laws of a foreign State, under cover of the rule of comity, would be a fraud upon the State granting the charter; and to attempt to act under such charter in the foreign State would be a fraud upon the latter.[333]

Some courts consequently refused to recognize the corporate status of these firms, treating them instead as partnerships and imposing liability on their promoters.[334]

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s*ee also* Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation*, 2 THEORETICAL INQUIRIES IN LAW 649, 654 (2001) (noting emergence of jurisdictional competition arguments in international financial regulation).

331. Frederick Tung, *From Monopolists to Markets?: A Political Economy of Issuer Choice in International Securities Regulation*, 2002 WIS. L. REV. 1363 (arguing that issuer choice proposals have overlooked critical choice of law issues); Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525 (2005) (challenging use of U.S. corporate charter competition as model for issuer choice in international securities regulation).

332. *See supra* notes 118-122 and accompanying text.

333. 2 VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 965(a) (2d ed. 1886) (1882).

334. *See* Cleaton v. Emery, 49 Mo. App. 345 (1892) (refusing to recognize in Missouri the corporate status of a firm incorporated in Colorado); Taylor v. Branham, 35 Fla. 297, 297 (1895) (holding that a corporation created in Tennessee cannot exercise corporate functions in Florida); *see also* 1 COOK, *supra* note 197, § 238 (citing other late-1800s authorities refusing recognition of pseudo-foreign corporations and imposing liability on stockholders as partners). Even in New York as late as 1891, it was apparently still a plausible argument that New York citizens who incorporated in another state intending to carry on the corporate business solely in New York had engaged in a fraudulent incorporation not deserving of recognition. While this argument was rejected by New York's high court in *Demarest v. Grant*, 128 N.Y. 205 (1891), it was not taken lightly. Well into the

Many a run-of-the-mill firm would likely have hesitated to test tramp incorporation in this uncertain environment. There was considerable risk in taking out a liberal charter from a state with no other connection to the business of the firm. Standard Oil, however, was no run-of-the-mill firm. Nor were the other trusts that became the targets for state attorneys general in the 1880s. The trusts thus played an important role in forcing—and winning—the issue. Less powerful firms with less dramatic corporate law needs would not likely have taken up the challenge or so readily won over recalcitrant host states.

It was in this legal and economic environment that state legislatures modified their strategies for corporate law and corporate regulation to permit strong-form charter competition. These various preconditions were essential for such competition to emerge and for the internal affairs doctrine to assume its central role in enabling this competition.[335]

This evolutionary tale of the internal affairs doctrine and modern charter competition refutes notions that the doctrine was inevitable or resulted from any underlying efficiency-enhancing rational design.[336] As Stephen Jay Gould has noted:

> A historical explanation does not rest on direct deduction from laws of nature, but on an unpredictable sequence of antecedent states, where any major change in any step of the sequence would have altered the final result. This final result is therefore dependent, or contingent, upon everything that came before—the unerasable and determining signature of history.[337]

The historical solution to the puzzle of the internal affairs doctrine casts doubt that fundamental institutional change may be accomplished merely through casual

twentieth century, courts distinguished true foreign corporations from pseudo-foreign corporations, treating the latter as a distinct category of problem. *See, e.g.*, Ernst v. Rutherford & Boiling Springs Gas Co., 56 N.Y.S. 403, 406 (N.Y. Gen. Term 1899) (holding there was subject matter jurisdiction for a restoration and accounting of a foreign corporation but not over an action to control internal management); Babcock v. Farwell, 245 Ill. 14, 36 (1910) (holding that a corporation may sue defaulting directors where they may be found); Corry v. Barre Granite & Quarry Co., 91 Vt. 413 (1917) (foreign corporation with agents and officers within court's jurisdiction subject to suit regarding internal affairs); Cunliffe v. Consumers Ass'n of Am., 280 Pa. 263, 273 (1924) (allowing a state court to appoint a receiver for a foreign corporation); Williamson v. Mo.-Kan. Pipe Line Co., 56 F.2d 503, 511 (7th Cir. 1932) (holding there is jurisdiction over a foreign corporation with officers and directors doing business in the state). "The modern corporation, wandering far from home very much like the 'emancipated' infant, raises a problem non-existent at the time the views of corporation law were first formulated." Comment, *Corporations—Interference With the Internal Affairs of a Foreign Corporation*, 31 MICH. L. REV. 682, 692 (1933).

335. This is not to say interjurisdictional pressures would not otherwise have affected the content of corporate law. Such pressures affect the content of all regulation. But the competition would likely not have taken the form of law-as-a-product competition. The dearth of law-as-a-product competition in other regulatory areas suggests the uniqueness of internal affairs doctrine.

336. Functional explanations for the internal affairs doctrine have cause and consequence exactly backwards. The doctrine was not designed to enable private choice and charter competition. Instead, charter competition evolved around the pre-existing internal affairs doctrine. But no one intended this at the doctrine's origin. The doctrine originally did not honor private choice but its opposite—states' territorial monopolies. Moreover, the doctrine may serve the ends of consistency and predictability in the modern context, as functional explanations have observed. But at the doctrine's origin, consistency and predictability were subsidiary concerns to—and byproducts of—courts' concern for the sovereignty of the incorporating state.

337. STEPHEN JAY GOULD, WONDERFUL LIFE: THE BURGESS SHALE AND THE NATURE OF HISTORY 283 (1989).

prescription. Markets for law may not form spontaneously. Existing institutional arrangements may matter, and they may or may not favor competition.[338] Prescriptions for competition may therefore be incomplete without careful consideration of existing institutional arrangements. More generally, legal prescriptions may necessitate substantial institutional adjustments. Besides identifying normatively attractive legal prescriptions—an important task in and of itself—scholars might do well to query the institutional basis for the status quo and marking—or at least suggesting—prospective paths to institutional reform.

Happily, in any event, my analysis may have something for everyone. While the historical contingency of state charter competition may dampen enthusiasm for broad prescriptions for strong-form regulatory competition, race-to-the-top advocates believing charter competition to be efficient can be grateful for the confluence of small events that pushed U.S. corporate law down the efficient path. Skeptics of regulatory competition, on the other hand, may also take some comfort. Even if one believes that the corporate law race among U.S. states runs downward, it may be a race whose running is confined to its particular historical path.

338. Recent developments in the European Union (EU) offer a nice contrast to this evolutionary tale of the internal affairs doctrine and state charter competition. Recent decisions of the European Court of Justice have effectively solved the choice of law problem, enabling firms to choose their jurisdiction of initial incorporation within the EU, regardless of the location of their headquarters, operations, or management. *See* Case C-212/97, Centros Ltd. v. Erhvervs- og Selskabsstyrelsen, 1999 E.C.R. I-1459; Case C-208/00, Überseering B.V. v. Nordic Construction Company Baumanagement GmbH (NCC), 2002 E.C.R. I-9919 (referred to the ECJ by the German Bundesgerichtshof (BGH), Resolution of 3/30/2000); Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10155). However, other institutional constraints have restricted free incorporation to small, new companies, and the terms of competition appear to be price related but not directly law related. The competition is being driven by differences in upfront setup costs at registration, minimum capital requirements, and waiting time to obtain legal status. Marco Becht, Colin Mayer, & Hannes F. Wagner, *Where Do Firms Incorporate*? 3 (European Corporate Governance Institute, Paper No. 70/2006, Sep. 2006), *available at* http://ssrn.com/abstract=906066. EU public companies cannot take advantage of this free incorporation because reincorporation requires dissolution, with its accompanying tax, notary, and other costs. *Id.* at 6 & n.10. There is additionally a supply problem. EU member states are prohibited from charging corporate franchise taxes of the type charged by Delaware and other U.S. states, so straightforward revenue incentives are absent. *Id.* at 6.