Chapter II

CHOICE OF LAW

A central feature of the global economy is the existence of corporations formed in one nation, but doing business in other nations. Whose corporate laws govern such firms?

McDERMOTT INCORPORATED v. LEWIS

531 A.2d 206 (Del. 1987).

We confront an important issue of first impression—whether a Delaware subsidiary of a Panamanian corporation may vote the shares it holds in its parent company under circumstances which are prohibited by Delaware law, but not the law of Panama. Necessarily, this involves questions of foreign law, and applicability of the internal affairs doctrine under Delaware law.

Plaintiffs, Harry Lewis and Nina Altman, filed these consolidated suits in the Court of Chancery in December, 1982 seeking to enjoin or rescind the 1982 Reorganization under which McDermott Incorporated, a Delaware corporation (''McDermott Delaware''), became a 92%-owned subsidiary of McDermott International, Inc., a Panamanian corporation (''International''). Lewis and Altman are stockholders of McDermott Delaware, which emerged from the Reorganization owning approximately 10% of International's common stock. Plaintiffs challenged this aspect of the Reorganization, and the Court of Chancery granted partial summary judgment in their favor, holding that McDermott Delaware could not vote its stock in International.

* * *

I.

International was incorporated in Panama on August 11, 1959, and is principally engaged in providing worldwide marine construction services to the oil and gas industry. Its executive offices are in New Orleans, Louisiana, and there are no operations in Delaware. International does not maintain offices in Delaware, hold meetings or conduct business here, have agents or employees in Delaware, or have any assets here.

McDermott Delaware and its subsidiaries operate throughout the United States in three principal industry segments: marine construction services, power generation systems and equipment, and engineered materials. McDermott Delaware's principal offices are in New Orleans.

Following the 1982 Reorganization, McDermott Delaware became a 92%-owned subsidiary of International. The public stockholders of International hold approximately 90% of the voting power of International, while McDermott Delaware holds about 10%.

The stated ''principal purpose'' of the reorganization, according to International's prospectus, was to enable the McDermott Group to retain, reinvest and redeploy earnings from operations outside the United States without subjecting such earnings to United States income tax. The prospectus also admitted that the 10% voting interest given to McDermott Delaware would be voted by International, ''and such voting power could be used to oppose an attempt by a third party to acquire control of International if the management of International believes such use of the voting power would be in the best interests of the stockholders of International.'' An exchange offer [under which McDermott Delaware stockholders exchanged their stock for shares in International], and thus the Reorganization, was supported by 89.59% of McDermott Delaware stockholders.

The applicable Panamanian law is set forth in the record by affidavits and opinion letters of Ricardo A. Durling, Esquire, and the deans of two Panamanian law schools, to support the claim that McDermott Delaware's retention of a 10% interest in International, and its right to vote those shares, is permitted by the laws of Panama. Significantly, the plaintiffs have not offered any contrary evidence.

* * *

[According to McDermott Delaware's experts, Panamanian law does not prohibit a subsidiary of a Panamanian corporation from voting shares the subsidiary owns in the parent corporation unless the Panamanian corporation registered its shares for trading within Panama with the National Securities Commission of Panama. While the case was awaiting decision by the Delaware Supreme Court, International registered—thereby precluding McDermott Delaware from being able to vote the shares it owned in International in the future.] This change in circumstances technically renders the appeal moot. Normally, we decline to decide moot issues. * * * Given the importance of this matter to Delaware corporation law, and the state in which it otherwise would be left, we are compelled to decide this case based on the facts presented to the trial court.

II.

We note at the outset that if International were incorporated either in Delaware or Louisiana, its stock could not be voted by a majority-

owned subsidiary. No United States jurisdiction of which we are aware permits that practice.

* * *

III.

* * *

Corporations and individuals alike enter into contracts, commit torts, and deal in personal and real property. * * * The internal affairs doctrine has no applicability in these situations. Rather, this doctrine governs the choice of law determinations involving matters peculiar to corporations, that is, those activities concerning the relationships inter se of the corporation, its directors, officers and shareholders.

The internal affairs doctrine requires that the law of the state of incorporation should determine issues relating to internal corporate affairs. * * *

A.

Delaware's well established conflict of laws principles require that the laws of the jurisdiction of incorporation—here the Republic of Panama—govern this dispute involving McDermott International's voting rights.

* * *

However, in *Western Air Lines, Inc. v. Sobieski*, 191 Cal.App.2d 399, 12 Cal.Rptr. 719 (1961), a California court upheld an order of the California Commissioner of Corporations directing a Delaware corporation having major contacts with California to follow the cumulative voting requirements imposed by California law. After the *Western Air* decision, commentators noted that the case signaled the alleged start of a ''conflicts revolution.'' * * *

A review of cases over the last twenty-six years, however, finds that in all but a few, the law of the state of incorporation was applied without any discussion. * * *

B.

Given the significance of these considerations, application of the internal affairs doctrine is not merely a principle of conflicts law. It is also one of serious constitutional proportions—under due process, the commerce clause and the full faith and credit clause—so that the law of one state governs the relationships of a corporation to its stockholders, directors and officers in matters of internal corporate governance. The alternatives present almost intolerable consequences to the corporate enterprise and its managers. With the existence of multistate and multinational organizations, directors and officers have a significant right, under the fourteenth amendment's due process clause, to know what law will be applied to their actions. Stockholders also have a right to know by what standards of accountability they may hold those managing the corpora-

tion's business and affairs. That is particularly so here, given the significant fact that in the McDermott Group reorganization, and after full disclosure, 89.59% of the total outstanding common shares of McDermott Delaware were tendered in the exchange offer. Thus, by an overwhelming choice those stockholders received shares in International, and thereby selected the laws of Panama to govern inter se the corporate relations between themselves, International, its directors, officers and agents. Such issues have been the subject of litigation and scholarly discussions for decades. However, an attitude has developed in some quarters which exalts local interests over more fundamental doctrines. We approach such teachings with reservations.

Under the commerce clause *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970), determined that a state may regulate interstate commerce indirectly, but emphasized that the burden placed upon interstate commerce may not be excessive in relation to the local interests served by the regulation. In *Edgar v. MITE Corp.*, 457 U.S. 624, 102 S.Ct. 2629, 73 L.Ed.2d 269 (1982), the Supreme Court ruled that under the commerce clause a state "has no interest in regulating the internal affairs of foreign corporations." If that is so, then a court or state which attempts to displace the internal affairs doctrine carries a heavy burden to justify its actions.

The recent decision in *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 107 S.Ct. 1637, 95 L.Ed.2d 67 (1987), seems to support this interpretation of *MITE*:

> This Court's recent Commerce Clause cases also have invalidated statutes that adversely may affect interstate commerce by subjecting activities to inconsistent regulations ... The Indiana Act poses no such problem. So long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one state. No principal of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders ... 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.

Thus, we conclude that application of the internal affairs doctrine is mandated by constitutional principles, except in "the rarest situations."

* * *

[A]pplication of [Delaware's corporate law] to International would violate the commerce clause. * * * For Delaware now to interfere in the internal affairs of a foreign corporation having no relationship whatever to this State clearly implies that International can be subjected to the differing laws of all fifty states on various matters respecting its internal affairs. * * *

IV.

Plaintiffs protest the issuance of voting stock to McDermott Delaware on public policy grounds, relying on the following statement from *Norlin* [*Corp. v. Rooney, Pace Inc.*, 744 F.2d 255 (2d Cir.1984)]:

> [The] statutes seek to safeguard minority shareholders from management attempts at self-perpetuation. If cross-ownership and cross-voting of stock between parents and subsidiaries were unregulated, officers and directors could easily entrench themselves by exchanging a sufficient number of shares to block any challenge to their autonomy....

* * * But here, we are called upon to apply the laws of Panama to a Panamanian corporation having no contacts with Delaware.

* * *

In conclusion, the trial court erred as a matter of law in ignoring the uncontroverted Panamanian law, and in applying Delaware and/or Louisiana law to the internal affairs of International contrary to established Delaware law and important constitutional principles. Accordingly the judgment of the Court of Chancery is REVERSED.

Notes

1. The court's holding in *McDermott* suggests that attorneys in the United States might need to become familiar with foreign corporate laws. Why was the relevant corporate law that of Panama (International's nation of incorporation) rather than Delaware (McDermott Delaware's state of incorporation)? Which company's internal affairs were at issue in this case?

2. The transaction in *McDermott* pioneered the so-called ''inversion'' or ''expatriation,'' in which a Delaware parent corporation and its non-United States subsidiary corporation switch roles—so that the Delaware corporation becomes the subsidiary, while the non-United States corporation becomes the parent—in order to reduce United States income taxes paid by the corporate group on its worldwide income. Other corporations, starting in the mid–1990s, followed suit. By the 2004 election year, the growing trend lead to complaints about disloyal corporations that became foreign in order to reduce their United States taxes in a time of war. In response, Congress amended the tax law to treat the foreign parent as a United States corporation for income tax purposes. I.R.C. § 7874(b) (as enacted by the American Jobs Creation Act of 2004).

3. The next case is a decision by the European Court of Justice involving provisions of the European Community Treaty. The legal structure governing what is now referred to as the European Union can be very difficult to fully understand. For present purposes, however, a grossly oversimplified description should suffice.

The European Union is the upshot of a series of treaties going all the way back to the Treaty of Paris of 1951 (which established the European Coal and Steel Community), to the two Treaties of Rome of 1957 (one of which established the European Atomic Energy Community, and the other

of which, most significantly of all, established the European Economic Community (the EEC, now just referred to as the European Community or EC)), through the 1993 Maastricht Treaty on European Union, and so on. The combined resulting governing document is referred to as the European Community (or EC) Treaty.

The EC Treaty establishes a number of governing bodies, including the European Council (comprised of representatives picked by the government of each member nation with the clear understanding that they are to represent the interests of their national governments), the European Commission (the members of which are to be independent of, even though nominated by, their national governments), and the European Parliament (directly elected by the people of the member nations). In fact, the European Council has the principal legislative authority, with the European Commission playing the role of proposing and implementing legislation, and the European Parliament playing a complex role in which its support of, or opposition to, legislation changes the requirements for adoption of the legislation by the European Council. The European Council enacts a couple of different types of legislation. ''Regulations'' are legislation that directly act as law, in the sense that national courts must apply them as relevant and they can create rights and liabilities for individuals. By contrast, ''directives'' are orders to the national legislatures in the member nations and require implementing national legislation.

The European Court of Justice (or ECJ) exists by virtue of the EC Treaty to ''ensure that in the interpretation and application of this Treaty the law is observed.'' Of most relevance for European Union corporate law, the ECJ can hear claims brought by the European Commission against member nations for failure to comply with treaty obligations, and can provide rulings, at the request of the national courts of European Union members, on the interpretation and application of EC Treaty provisions.

KAMER VAN KOOPHANDEL EN FABRIEKEN VOOR AMSTERDAM v. INSPIRE ART LTD.

Case C–167/01, 2003 E.C.R. I–10155 (European Court of Justice 2003).

* * *

I—The legal framework

The relevant provisions of Community law

The first paragraph of Article 43 EC [Treaty] provides:

> Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Article 48 EC extends entitlement to freedom of establishment, subject to the same conditions as those laid down for individuals who are nationals of the Member States, to ''companies or firms formed in accordance with the law of a Member State and having their registered

office, central administration or principal place of business within the Community''.

Article 46 EC permits the Member States to restrict the freedom of establishment of foreign nationals by adopting ''provisions laid down by law, regulation or administrative action'', in so far as such provisions are justified ''on grounds of public policy, public security or public health''.

Article 44(2)(g) EC empowers the Council of the European Union, for the purpose of giving effect to freedom of establishment, to coordinate ''to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 of the EC Treaty with a view to making such safeguards equivalent throughout the Community.''

Various directives have in that manner been adopted by the Council on that basis (''company-law directives'') and, in particular, the following directives referred to in the dispute in the main proceedings.

* * *

The Eleventh Council Directive [specifies] * * * disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State.

* * *

According to the fifth recital in the preamble to [the Eleventh] directive ''in this field the differences in the laws of the Member States may interfere with the exercise of the right of establishment . . . [and] it is therefore necessary to eliminate such differences in order to safeguard, inter alia, the exercise of that right''.

* * *

The relevant provisions of national [Netherlands] law

Article 1 of the [Wet op de Formeel Buitenlandse Vennotschappen (Law on Formally Foreign Companies) of 17 December 1997 (the ''WFBV'')] defines a ''formally foreign company'' as ''a capital company formed under laws other than those of the Netherlands and having legal personality, which carries on its activities entirely or almost entirely in the Netherlands and also does not have any real connection with the State within which the law under which the company was formed applies . . . ''.

Articles 2 to 5 of the WFBV impose on formally foreign companies various obligations concerning the company's registration in the commercial register, an indication of that status in all the documents produced by it, the minimum share capital and the drawing-up, production and publication of the annual documents. The WFBV also provides for penalties in case of non-compliance with those provisions.

In particular, Article 2 of the WFBV requires a company falling within the definition of a formally foreign company to be registered as such in the commercial register [in the Netherlands].

* * *

Pursuant to Article 4(1) of the WFBV, the subscribed capital of a formally foreign company must be at least equal to the minimum amount required of Netherlands limited companies by Article 2:178 of the * * * Netherlands Civil Code, which was EUR 18,000 on 1 September 2000. * * *

Until the conditions relating to capital and paid-up share capital have been satisfied, the directors are jointly and severally liable with the company for all legal acts carried out during their directorship which are binding on the company.

* * *

II—The dispute in the main proceedings and the questions referred for a preliminary ruling

Inspire Art was formed on 28 July 2000 in the legal form of a private company limited by shares under the law of England and Wales and it has its registered office at Folkestone (United Kingdom). Its sole director, whose domicile is in The Hague (Netherlands), is authorised to act alone and independently in the name of the company. The company, which carries on activity under the business name "Inspire Art Ltd" in the sphere of dealing in objets d'art, began trading on 17 August 2000 and has a branch in Amsterdam.

Inspire Art is registered in the commercial register of the Chamber of Commerce without any indication of the fact that it is a formally foreign company within the meaning of Article 1 of the WFBV.

Taking the view that that indication was mandatory on the ground that Inspire Art traded exclusively in the Netherlands, the Chamber of Commerce applied to the Kantongerecht te Amsterdam [a Netherlands court] on 30 October 2000 for an order that there should be added to that company's registration in the commercial register the statement that it is a formally foreign company, in accordance with Article 1 of the WFBV, which would entail other obligations laid down by law, set out * * * above.

Inspire Art denie[d, in the Netherlands court proceeding,] that its registration is incomplete, primarily because the company does not meet * * * [the definition of a formally foreign company within the meaning of] the WFBV. As a secondary point, if the Kantongerecht were to decide that it met [that definition], it maintained that the WFBV was contrary to Community law, and to Articles 43 EC and 48 EC in particular.

In its order of 5 February 2001 the Kantongerecht held that Inspire Art was a formally foreign company within the meaning of Article 1 of the WFBV.

As regards the compatibility of the WFBV with Community law, [the Netherlands court] decided to stay proceedings and refer the following questions to the Court of Justice for a preliminary ruling:

> Are Articles 43 EC and 48 EC to be interpreted as precluding the Netherlands, pursuant to the [WFBV], from attaching additional conditions, such as those laid down in Articles 2 to 5 of that law, to the establishment in the Netherlands of a branch of a company which has been set up in the United Kingdom with the sole aim of securing the advantages which that offers compared to incorporation under Netherlands law, given that Netherlands law imposes stricter rules than those applying in the United Kingdom with regard to the setting-up of companies and payment for shares, and given that the Netherlands law infers that aim from the fact that the company carries on its activities entirely or almost entirely in the Netherlands and, furthermore, does not have any real connection with the State in which the law under which it was formed applies?

* * *

[IV—] Consideration of the questions referred

* * *

[S]everal of the provisions of the WFBV fall within the scope of the Eleventh Directive, since that concerns disclosure requirements in respect of branches opened in a Member State by companies * * * governed by the law of another Member State.

* * *

[The court pointed out that while some of the disclosure requirements imposed by the WFBV on formally foreign corporations were consistent with the Eleventh Directive, some went beyond the disclosure called for by that directive.]

It is therefore necessary to consider, with regard to those obligations, whether the harmonisation brought about by the Eleventh Directive * * * is exhaustive.

* * *

[I]t follows from the * * * fifth recital in the preamble to the Directive that the differences in respect of branches between the laws of the Member States, especially as regards disclosure, may interfere with the exercise of the right of establishment and must therefore be eliminated.

* * *

It must therefore be concluded on this point that it is contrary to * * * the Eleventh Directive for national legislation such as the WFBV to impose on the branch of a company formed in accordance with the laws of another Member State disclosure obligations not provided for by that directive.

[S]everal of the provisions of the WFBV do not fall within the scope of the Eleventh Directive. Those are the rules relating to the minimum capital required, both at the time of registration and for so long as a formally foreign company exists, and those relating to the penalty attaching to non-compliance with the obligations laid down by the WFBV, namely, the joint and several liability of the directors with the company (Article 4(1) and (2) of the WFBV). Those provisions must therefore be considered in the light of Articles 43 EC and 48 EC.

* * *

The Court has held that it is immaterial, having regard to the application of the rules on freedom of establishment, that the company was formed in one Member State only for the purpose of establishing itself in a second Member State, where its main, or indeed entire, business is to be conducted. The reasons for which a company chooses to be formed in a particular Member State are, save in the case of fraud, irrelevant with regard to application of the rules on freedom of establishment (*Centros*).

* * *

Thus, in the main proceedings, the fact that Inspire Art was formed in the United Kingdom for the purpose of circumventing Netherlands company law which lays down stricter rules with regard in particular to minimum capital and the paying-up of shares does not mean that that company's establishment of a branch in the Netherlands is not covered by freedom of establishment as provided for by Articles 43 EC and 48 EC. * * *

The argument that freedom of establishment is not in any way infringed by the WFBV inasmuch as foreign companies are fully recognised in the Netherlands and are not refused registration in that Member State's business register, that law having the effect simply of laying down a number of additional obligations classified as "administrative", cannot be accepted.

* * *

The legislation at issue in the case in the main proceedings, which requires the branch of such a company formed in accordance with the legislation of a Member State to comply with the rules of the State of establishment on share capital and directors' liability, has the effect of impeding the exercise by those companies of the freedom of establishment conferred by the Treaty.

* * *

Whether there is any justification

* * *

It must first of all be stated that none of the arguments put forward by the Netherlands Government with a view to justifying the legislation at issue in the main proceedings falls within the ambit of Article 46 EC.

The justifications put forward by the Netherlands Government, namely, the aims of protecting creditors, combating improper recourse to freedom of establishment, and protecting both effective tax inspections and fairness in business dealings, fall therefore to be evaluated by reference to overriding reasons related to the public interest.

It must be borne in mind that, according to the Court's case-law, national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must, if they are to be justified, fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the public interest; they must be suitable for securing the attainment of the objective which they pursue, and they must not go beyond what is necessary in order to attain it.

In consequence, it is necessary to consider whether those conditions are fulfilled by provisions relating to minimum capital such as those at issue in the main proceedings.

First, with regard to protection of creditors, and there being no need for the Court to consider whether the rules on minimum share capital constitute in themselves an appropriate protection measure, it is clear that Inspire Art holds itself out as a company governed by the law of England and Wales and not as a Netherlands company. Its potential creditors are put on sufficient notice that it is covered by legislation other than that regulating the formation in the Netherlands of limited liability companies and, in particular, laying down rules in respect of minimum capital and directors' liability.

* * *

The answer to be given to the second question referred by the national court must therefore be that the impediment to the freedom of establishment guaranteed by the Treaty constituted by provisions of national law, such as those at issue, relating to minimum capital and the personal joint and several liability of directors cannot be justified under Article 46 EC, or on grounds of protecting creditors, or combating improper recourse to freedom of establishment or safeguarding fairness in business dealings or the efficiency of tax inspections.

In light of all the foregoing considerations, the answers to be given to the questions referred for a preliminary ruling must be:

—It is contrary to Article 2 of the Eleventh Directive for national legislation such as the WFBV to impose on the branch of a company formed in accordance with the laws of another Member State disclosure obligations not provided for by that directive.

—It is contrary to Articles 43 EC and 48 EC for national legislation such as the WFBV to impose on the exercise of freedom of secondary establishment in that State by a company formed in accordance with the law of another Member State certain conditions provided for in domestic company law in respect of company formation relating to minimum capital and directors' liability. The reasons for which the

company was formed in that other Member State, and the fact that it carries on its activities exclusively or almost exclusively in the Member State of establishment, do not deprive it of the right to invoke the freedom of establishment guaranteed by the EC Treaty, save where the existence of an abuse is established on a case-by-case basis.

* * *

KAISHA HOU [CORPORATIONS LAW] ART. 821

(Japan 2005).

Article 821 (Pseudo–Foreign Companies)

(1) A foreign company that has a head office in Japan, or whose principal purpose is the carrying on of business in Japan, may not continuously engage in transactions in Japan.

Any person who engages in transactions in violation of the provisions of the preceding paragraph shall, in relation to counterparties, be jointly and severally liable with the foreign company for repayment of any debts incurred as a result of such transactions.

Notes

1. *McDermott* and *Inspire Art* involve companies that incorporated in one nation and did business in another. In a global economy, this fact is unexceptional. These two cases involve something more, however, than a company doing business in a nation other than where it incorporated. In both cases, it appears that the companies conducted little or no business in (or had much of any other connection with) the nation of incorporation. Hence, the holdings in both *McDermott* and *Inspire Art* stand for the proposition that parties forming a corporation essentially can pick their corporate law from the menu of choices provided by other nations—regardless of where the company actually operates or where its shareholders reside. This has profound consequences from the standpoint of both lawyers advising clients and policy makers considering corporate regulation.

Not every jurisdiction accepts this notion of free choice of corporate law, as illustrated by Article 821 of Japan's newly redrafted corporation statute, as well as the California law applied by the *Wilson* decision criticized in *McDermott*. Actually, the Japanese statute and California law address this issue in two very different ways, in that each attacks a different legal leg upon which the free choice regime rests.

The first leg upon which the free choice regime rests is the notion that persons can form corporations in jurisdictions other than one in which the company will conduct operations. The notion that the mere filing of a piece of paper (combined with a nominal local address) dictates the nation (or state) of incorporation is often referred to the incorporation doctrine, and characterized as an Anglo–American view. By contrast, many continental European nations traditionally operated under the view that corporations must be formed in the nation in which the company had its headquarters—

variously called the *siege social*, *siege real*, or seat theory. Under this view, a nation would reject the effort to incorporate under its law if the corporate headquarters would be in another nation, and a nation in which a firm had its headquarters would refuse to recognize the firm as a corporation—meaning, for example, the firm would lack the capacity to sue in this nation's courts and its owners might face personal liability—unless the firm incorporated under this nation's, rather than another nation's, laws. *E.g.*, Wulf–Henning Roth, *From Centros to Uberseering: Free Movement of Companies, Private International Law, and Company Law*, 52 Int'l & Comp. L.Q. 177, 180–185 (2003). This is generally the approach taken by Japan's Article 821.

Both the Netherlands' statute dealing with ''formally foreign corporations,'' and the California law applied in the *Wilson* case (specifically, a California statute dealing with ''quasi foreign corporations''), attack the matter from the other leg. These laws recognize the existence of the foreign corporation, but, at least partially, reject the internal affairs rule in favor of applying various parts the corporate law of the nation (or state) that has more actual contacts with the corporation's activities and shareholders.

From a legal (rather than a policy) standpoint, a nation, like Japan, is at liberty to refuse to recognize the existence of foreign corporations whose activities are predominately within the nation, rather than where the company incorporated. Alternately, a nation can reject the internal affairs doctrine in favor of other choice-of-law principles. As the discussion in *McDermott*, and the result in *Inspire Art*, indicate, things change when states or nations are part of a federal system or linked by treaty regulating their economic activities.

A substantial motivation both for the United States Constitution, and for the treaties creating the European Union, was to eliminate barriers that the member states or nations had constructed to trade between themselves. Hence, it is not surprising that the governing documents in both cases contain provisions—the Commerce Clause in the case of the United States Constitution, the articles calling for freedom of establishment in the case of the EC Treaty—that the courts in *McDermott* and *Inspire Art* held to limit the ability of a state in the United States, or a nation in the European Union, to interfere with the free choice of corporate law.

When the United States Constitution was drafted, corporations were hardly the dominant business form that they are today. Hence, it is understandable why the Constitution contains no direct reference to regulation of corporations. By contrast, modern recognition of the important role of corporations resulted in Articles 43 and 48 of the EC Treaty, which expressly require member nations in the European Union to allow companies formed under the laws of other member nations to set up shop. *Inspire Art* is the third of a trilogy of cases by the ECJ, which applied these articles to situations in which Danish, German and Dutch nationals had formed English (or, ironically in the German case, Netherlands) companies to conduct business in their home countries. Simplifying the matter, the first two of these cases (Case C–212/97 *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I–1459, and Case C–208/00 *Uberseering BV v. Nordic Construction Co. Baumanagement*, 2002 E.C.R. I–9919) held that these articles

compelled recognition of corporations formed under one member nation's law, despite the fact that the headquarters, business and owners of the company were all within the nation that refused to recognize the corporation. The result essentially is to prevent application of the seat theory, at least in the context of refusing to recognize corporations formed under the laws of European Union member nations following the incorporation doctrine. The Dutch law involved in *Inspire Art* sought to get around these results by recognizing the non-Dutch corporation, but seeking to apply certain parts of Dutch law. In this situation, how exactly does forcing such companies to live with the same law as Dutch corporations, interfere with freedom of establishment?

From a policy standpoint, notice that both *McDermott* and *Inspire Art* reflect a philosophy toward choice of law that sees nothing wrong with organizers of a corporation being able to choose in a ''marketplace for competing laws'' the law they find most attractive. Does this regime allow organizers to choose laws that prejudice shareholders (the Panamanian voting rules in *McDermott*) or creditors (the English minimum capital rules in *Inspire Art*) of the corporation? Does the fact, emphasized by the court in *McDermott*, that over 90 percent of the McDermott Delaware shareholders volunteered to trade their shares for stock in International—knowing that International was a Panama corporation and that Panama law would allow the subsidiary to vote its stock in the parent—eliminate this concern? Were there some reasons why the shareholders might have made the exchange—for example, fear of remaining a shareholder in a subsidiary—even if they did not care for Panamanian law. The court in *Inspire Art* extends this ''protect yourself'' approach to cast aside the Netherlands' concern for creditors of poorly capitalized English companies doing business in the Netherlands, by pointing out that the creditors will know that they are dealing with an English corporation. Is it realistic to expect that persons doing business with a gallery on a street in Amsterdam are going to be aware both of the gallery's nation of incorporation and of the capital rules provided by that nation's corporate law? (Incidentally, notice how the court in *Inspire Art* held that Article 46's ''public policy'' justification was entirely inapplicable; thereby forcing the Netherlands to defend the law against an apparently more demanding judicially-created ''public interest'' justification.)

2. Federal regimes not only can constrain member states to follow the corporate laws of other member states, but also can impose corporate laws adopted by the national government (in the case of the United States) or European governing bodies (in the case of the European Union). In the United States, the principal national ''corporate'' law comes from the 1933 Securities Act, and the 1934 Securities Exchange Act, as amended and supplemented particularly by the Williams Act in 1968 and the Sarbanes–Oxley Act in 2002. As discussed in *Inspire Art*, the principal European corporate law comes from the directives promulgated by the European Council pursuant to Article 44 of the EC Treaty.

There are several broad conceptual differences between the United States federal law in the corporate area provided by the securities laws, and the European corporate law provided by the European Council directives. The first is the purpose of the laws. As stated by the court in *Inspire Art*, the purpose of directives promulgated pursuant to Article 44 is to harmonize the

disparate corporate laws in the member nations of the European Union in order to promote free establishment of corporations in member nations. By contrast, the purpose of the securities laws in the United States, for the most part, is not to promote any notion of uniformity for its own sake, but rather to address concerns Congress did not feel adequately dealt with under state law. Related to this difference in purpose is a difference in scope—the European Council harmonization directives cover a much broader range of corporate law topics than do the securities laws in the United States (the focus of which is principally on disclosure to investors). For example, the European Council directives actually cover the subject of minimum capital—but only for corporations with marketable stock, rather than for the sort of private companies involved in *Inspire Art*. Finally, as discussed earlier, directives (unlike the United States securities laws) do not in themselves have the effect of law; rather they are instructions to the legislatures of the member nations of the European Union as to what the national corporate legislation must contain.

The Eleventh European Council Directive created an issue in *Inspire Art* as to whether member nations could mandate more disclosure than the directive required to be in their corporate laws. Compare the court's interpretation of the Eleventh Directive, with Section 18(a) and (b) of the 1933 Securities Act (as amended), which preempt any state securities laws in the United States from requiring registration of so-called covered securities, but otherwise do not preempt state securities regulation. Actually, however, despite the goal of harmonization, and the court's interpretation of the Eleventh Directive to preclude more extensive disclosure requirements in the areas covered by the directive, corporate law within the European Union remains far from uniform. For one thing, the directives commonly contain options, or act as a floor above which member nations can impose higher standards, rather than, as the court interpreted the Eleventh Directive, creating one exclusive rule. *E.g.*, Vanessa Edwards, EC COMPANY LAW 10 (1999). In addition, the more fundamental the difference in corporate law—as, for example, the requirement in some European Union member nations that employees have the right to elect some members to the corporation's board (co-determination)—the more difficult it becomes to gain the necessary consensus in the European Council behind a directive. Hence, directives have not harmonized many of the more fundamental differences in European corporate laws.

A more extreme possibility for a central corporate law in a federal regime would be to have companies form under a national (as opposed to a state) corporation law in the United States, or under a European (as opposed to an English, Netherlands, etc.) corporation law in the European Union. With certain specialized exceptions (banks), there seems little likelihood of the United States moving to a system of federally chartered corporations. By contrast, many countries with federal systems (e.g., Germany) charter corporations under a national, rather than a local, corporate law. A few years ago, the European Council promulgated a regulation creating a ''Societas Europaea'' (an SE). The idea was to allow persons to form a European, rather than a German, English, etc. corporation. The SE, however, is a sort of mixing of national and European laws, such that an SE formed in one country will not follow all the same corporate rules as an SE formed in

another country, and it is uncertain how much use this entity will see. *E.g.*, Theo Raaijmakers, *The Statute for a European Company: Its Impact on Board Structures, and Corporate Governance in the European Union*, 5 European Bus. Org. L. Rev. 1 (2004).

From a policy standpoint, what are the advantages the European Union seeks by harmonizing (or supplanting with an SE) national corporate laws? Are there some advantages the United States has gained by allowing different states to have different corporate laws? Will such divergence, when combined with free choice of corporate law, lead to ever less protective corporate law (a ''race to the bottom''), or to ever more efficient corporate law (''a race to the top'')?

3. The jurisdictional reach of United States securities laws is not limited to corporations formed or operating in the United States. Rather, the basis for jurisdiction under these laws is the use of means of interstate commerce, the United States mail, or a national securities exchange to engage in specified conduct (e.g., sale of a security). Hence, these laws apply to non-United States corporations that sell their stock in the United States, or, of particular significance, list their stock for trading on stock exchanges in the United States (such as the New York Stock Exchange).

The reach of United States securities laws to non-United States corporations based upon their listing stock or other securities for trading on the New York Stock Exchange creates its own prospects for choice of corporate law. Is it possible that some foreign corporations list on the New York Stock Exchange, less to have access to United States financial markets, than to subject themselves to United States securities laws? Why would a corporation wish to subject itself to potentially more burdensome regulation? Consider what unspoken message such an action might convey to potential investors in the corporation. For an empirical examination of whether Israeli corporations have been listing on United States stock exchanges in order to gain investor confidence by complying with higher United States disclosure requirements, see, *e.g.*, Ariel Yehezkel, *Foreign Corporations Listing in the United States—Does Law Matter? Testing the Israeli Phenomenon* (September 3, 2005), U Illinois Law & Economics Research Paper No. LE05–023, available at SSRN: http://ssrn.com/abstract=797504.

On the other hand, application of United States securities law to non-United States corporations, which list on the New York Stock Exchange, can create the sort of conflicts between inconsistent regulation that worried the court in *McDermott*. Section 301 of the Sarbanes–Oxley Act requires corporations, in order to list their stock on a national stock exchange in the United States, to have an audit committee of the board of directors, composed of independent directors, select the corporation's outside auditors. On its face, this creates conflicts with corporate statutes in some other jurisdictions in which either (i) shareholders select auditors, or (ii) employees are entitled to elect a certain percentage of the board (since the employee representatives might not meet the definition of an independent director for purposes of the Sarbanes–Oxley Act). One answer to such conflicts has been for the Securities Exchange Commission to create special rules for non-United States corporations. Securities Exchange Commission, Release Nos. 33–8220, 34–47654, Standards Relating to Listed Company Audit Committees, 68 FR

18788, 18802 (April 16, 2003). Another answer might be for foreign corporations to delist from United States stock exchanges. *E.g.*, Daniel Epstein, *Goodbye, Farewell, Auf Wiedersehen, Adieu* . . . , Wall St. J. A10 (February 9, 2005).

4. In discussing what corporate law governs a particular company, it is useful to note that the boundaries of what constitutes ''corporate law'' are not exact. Indeed, questions exist both as to what rules constitute ''law'' and what laws are part of ''corporate'' law.

For example, governmental and non-governmental organizations in many nations have adopted various corporate governance codes. *E.g.*, Robert A.G. Monks & Nell Minow, CORPORATE GOVERNANCE 251–258 (2d ed. 2001). These codes normally are voluntary in the sense that no legal liability results from the failure to comply—albeit, some national corporate laws may require companies publicly to explain failure to comply with the code, and various privileges (such as listing for trading on a stock exchange) may be denied for non-compliance. Many have argued that such codes create norms that impact corporate behavior even without sanctions attached. Hence, regardless of whether such codes are ''law'' (depending upon how one defines this term), corporate attorneys often find such codes of interest.

An earlier note referred to the 1933 Securities Act and 1934 Securities Exchange Act as national ''corporate'' law in the United States. Many readers might object by arguing that securities laws are not corporate law. In fact, many other nations include disclosure rules in their company laws, and so what is corporate law and what is capital markets (or securities) law is in the eye of the beholder. Similarly, some nations might have rules protecting creditors of corporations in the nation's corporate laws, while other nations might have rules along the same lines in bankruptcy or insolvency laws. Also, are laws giving workers a voice in running corporations part of corporate law or employment law? One impact of this divergence is to suggest that one should not decide which issues come within the internal affairs rule simply by rote application of the label corporate law. Another impact is to suggest that, in conducting legal research, especially involving law of another nation, the applicable rule could be in an entirely different body of law than one expected.