Vanderbilt Journal of Transnational Law

Volume 19
Issue 3 *Summer 1986*

Article 1

1986

Private International Law as a Means to Control the Multinational Enterprise

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Vanderbilt Journal of Transnational Law

VOLUME 19 SUMMER 1986 NUMBER 3

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I. INTRODUCTION

In one of Professor Vagts' articles reviewing the publications on multinational enterprises, a field which in 1982 merited a 426-page catalog by the United Nations Centre on Transnational Corporations,[1] he observes that European — particularly German — and United States legal writers have approached the phenomenon of multinational enterprise differently.[2] He noted that the more "case-oriented, pragmatic" commentators in the United States, who assume that multinationals are of such fundamental importance to the international economy that the law should treat them as "roughly equivalent to states," tend to advocate control by "rules parallel to those of [P]ublic [I]nternational [L]aw."[3] Their "theoretical and abstract" German colleagues,[4] however, evince more concern with Private International Law questions, such as the recognition of foreign corporations and the choice of law governing corporate affairs.[5]

The different approaches are less attributable to the dissimilarities between their legal systems than to structural particularities of the economic and political environment in Europe. While the integration of multinational enterprises in an economic community without a uniform business law provides easy access to the economies of the member states, it also poses a host of complicated Private International Law problems. These problems do not arise in the United States largely because its corporate law has long and consistently adhered to the place of incorporation theory.[6]

Although the EEC-Draft Code of Principles for Multinational Enterprises and Governments[7] and the impact of the OECD Guidelines for Multinational Enterprises[8] on the settlement of European employment

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1. Vagts, *Foreword* to C.D. WALLACE, LEGAL CONTROL OF THE MULTINATIONAL ENTERPRISE at vii (1982).

2. Vagts, *The Multinational Enterprise: A Ten Years' Review*, 25 DIE AKTIENGESELLSCHAFT 154, 156-58 (1980).

3. *Id.* at 157.

4. *Id.*

5. *Id.* at 156.

6. *Id.*

7. Draft Code of Principles for Multinational Enterprises and Governments, 20 O.J. EUR. COMM. (No. C 118), at 16-21 (1977) (annex to the resolution of the European Parliament dated Apr. 19, 1977, "on principles to be observed by enterprises and governments in international economy activity").

8. Organization for Economic Cooperation and Development Guidelines for Multinational Enterprise, OECD Doc. PRESS/A(76) 20 (1976), *reprinted in* Wakkie, *Some Comments on the Impact of the OECD Guidelines for Multinational Enterprises on*

disputes[9] show that since the late 1970s Western Europe has shifted toward quasi-Public International Law regulations, [10] Professor Vagts' remarks are still largely valid and act as an incentive for the re-examination of the Private International Law approach. Assuming that each host state seeks to maximize the benefits and minimize the adverse effects that the activities of the multinational enterprises might have on the host state's realization of its political, economic and social goals, the optimal legal policy vis-à-vis multinationals is one which offers a control mechanism that is effective, yet which does not impose unnecessary restraints on corporate behavior.

This Article explores the different approaches taken by the academic and judicial communities of Germany and the United States in their respective attempts to derive the optimal legal policy to deal with the multinational enterprise phenomenon. It attempts to assess the success of the Private International Law method as applied in most European countries by examining whether its criteria are operational and a reflection of economic reality. The Article also analyzes whether application of such criteria ensures the enforcement of the policies of the forum. It concludes by questioning whether the Private International Law approach is a viable alternative to the Public International Law approach.

II. Place of Incorporation v. Effective Seat Theory

The area of law governing the corporate affairs of multinational enterprises traditionally has been the battlefield of two theoretical concepts. The Anglo-American conflict of laws adheres to the incorporation theory, which is based upon the concept that a corporation should abide by the law of the country from which it derives its existence without regard to its contacts with a second country. The doctrine originated in Great Britain during the eighteenth century. Great Britain intended for the doctrine to permit the "export" of British law to its colonies, and to provide both certainty of law as well as enforcement of the corporation's interests when such interests conflicted with those of the host state. Even today, the incorporation theory principally works to facilitate the activities of powerful investors in foreign markets.[11]

European Employment Relations, 2 Loy. L.A. Int'l & Comp. L. Ann. 75, 94-103 (1979).

9. *See, e.g.*, R. Blanpain, The OECD Guidelines for Multinational Enterprises and Labour Relations 1976-1979 (1979); Wakkie, *supra* note 8, at 75.

10. The EEC draft code and the OECD guidelines are evidence of a developing trend among European governments to treat multinational enterprises like states.

11. C.T. Ebenroth, Die verdeckten Vermögenszuwendungen im transna-

The effective seat theory is of more recent origin. It was developed mainly in France and Germany during the nineteenth century[12] and, in fact, it merely varies the incorporation theory by adding the requirement of domicile to that of incorporation.[13] Accordingly, this theory recognizes that a corporation's legal existence begins upon its incorporation under the law of the state in which its seat is located. The corporate seat concept has been defined in two alternative ways. The first regards the corporation as centered at the place at which it "carries on the manufacturing, trading, or other activities indicated in [its] charter [*siège d'exploitation*]."[14] The second focuses on the corporation's place of central administration, that is the place from which its operations are directed and its policy controlled (*siège réel, siège social*).[15]

Although France applied the first corporate seat theory initially,[16] most Continental-European countries now regard the site of the corporate headquarters as the determining factor in locating the corporation.[17] It remains unclear, however, whether the meeting place of the directors or that of the shareholders should be considered as the place of central administration. In fact, the flexibility of the multinational enterprise requires the consideration of various factors in order to avoid results which do not reflect economic reality. Therefore, courts of the same country may operate with different criteria, depending upon the facts of each particular case.[18] The effective seat concept assumes that the state of central administration is the one primarily affected by the activities of the corporation, and that it should be able to protect its legitimate interests by applying its own law to the corporation's activities. Thus, compared with the theory of incorporation, the effective seat concept is rather "defensive" in its rejection of the exportation of foreign law to host states.

The incorporation theory's flexibility is both its primary strength and

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TIONALEN UNTERNEHMEN 354-55 (1979).

12. Staudinger-Grossfeld, *Internationales Gesellschaftsrecht*, in 2A STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH, para. 18 (10th & 11th eds. 1981) [hereinafter STAUDINGER-GROSSFELD]. For an historical overview, see B. GROSSFELD, PRAXIS DES INTERNATIONALEN PRIVAT- UND WIRTSCHAFTSRECHTS 26-40 (1975).

13. 2 E. RABEL, THE CONFLICT OF LAWS: A COMPARATIVE STUDY 33, 38 (2d ed. 1960).

14. *Id.* at 40.

15. *Id.* at 40-46.

16. *See id.* at 40.

17. *See* STAUDINGER-GROSSFELD, *supra* note 12, para. 120 (discussing the theory applicable in various Continental-European countries).

18. *See* Hadari, *The Choice of National Law Applicable to the Multinational Enterprise and the Nationality of Such Enterprises*, 1974 DUKE L.J. 1, 8-9; *see also* R. PENNINGTON, COMPANIES IN THE COMMON MARKET 98-99 (2d ed. 1970).

most significant weakness. An enterprise's freedom to choose the law of any country to govern its corporate affairs, without also being required to have any real contact with the country of incorporation and without having to confront the problem of its recognition as a legal entity by the states in which it conducts its business activities, guarantees to the enterprise a great deal of entrepreneurial choice and certainty of law.

The unlimited "freedom to choose," however, also can be misused to circumvent unpleasant laws of the host state. This goal is achievable without resort to incorporation in "exotic" countries like the Bahamas, Curaçao or Andorra. Incorporation in a country whose law is relatively more permissive than the law of the host state under the corporate seat theory is enough to grant the enterprise an unfair advantage over domestic competitors. The German law of workers' "co-determination" is a notable example of a statute which might be circumvented.[19] Since some European laws do not include similar provisions, an enterprise that is effectively German could evade the workers' participation requirement by incorporating in another European country.

Numerous arguments also have been leveled against the corporate seat theory. As with many theoretical controversies, the majority of these arguments either have been invalidated by subsequent developments in the theory or have not been sufficiently persuasive to challenge the theory's legitimacy as a "second-best" choice. Nevertheless, a close analysis raises serious doubts about both the theory's soundness as well as the appropriateness of certain results of its application.

Theoretically, the corporate seat concept suffers from contradictions that arise from the efforts of its advocates to cover cases that otherwise would be subject to a law other than that of the forum. For example, the German law relating to groupings of enterprises (*Konzernrecht*), which is aimed at protecting the corporate position of minority shareholders and creditors of subsidiaries against the specific risks which might emerge from their status of subordination,[20] applies to relations between a foreign parent company and its German subsidiary. While this point is not disputed by legal commentators,[21] their methods of reasoning may follow different paths.[22] The majority opinion determines the application

19. *See infra* notes 28-41 and accompanying text.

20. *See* 1 H. WIEDEMANN, GESELLSCHAFTSRECHT 801 (1980).

21. *See, e.g.*, STAUDINGER-GROSSFELD, *supra* note 12, para. 390.

22. *See id.* For detailed presentations of the different paths, see Wiedemann, *Internationales Gesellschaftsrecht*, in INTERNATIONALES PRIVATRECHT UND RECHTSVERGLEICHUNG IM AUSGANG DES 20. JAHRHUNDERTS 197, 203-06 (1977); Ebenroth, Nach Art. 10, in 7 MÜNCHENER KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH, paras. 338-47 (1983) [hereinafter MÜNCHKOMM-EBENROTH].

of the law concerning groups of enterprises according to the same criterion as the law governing corporate affairs—the location of the corporation's effective seat. Pursuant to this view there is a sort of "reflection" of the law governing the corporate affairs of the subsidiary over the parent company, by setting limits on the discretionary powers of the latter.[23] While the concept seems to work in decentralized groups of companies, a subsidiary which has entered into a so-called "contract of domination" under section 291(1) of the German Stock Corporation Law[24] loses its autonomy of planning and is directed from abroad by the parent company. This means that the seat of the subsidiary is not in Germany but in the state in which its parent is located and the law that governs its corporate affairs should not be German. Consequently, the German law concerning groups of corporations also could not be applicable since there is no "reflection" of German law over the foreign parent.

The reaction of the effective seat theorists to this fallacy was to modify the notion of the seat in a way that would permit the application of German law. The location of the seat had to shift from the place at which the important policy directives are adopted to the place at which these directives are transformed into "everyday administrative decisions."[25] Although this solution ensures that forum law is applicable and solves the problem of determining the seat of corporations with headquarters in more than one country,[26] it contradicts the effective seat concept, which is supposed to focus on the "nerve center" of the corporation. Moreover, this kind of overlapping of the effective seat with the registered seat overlooks the fact that the basic assumption of the seat the-

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23. 1 H. WIEDEMANN, *supra* note 20, at 800 & n.1, 801; *cf.* Rehbinder, *Das auf multinationale Unternehmen anwendbare Recht*, in DEUTSCHE ZIVIL- UND KOLLISIONSRECHTLICHE BEITRÄGE ZUM IX. INTERNATIONALEN KONGRESS FÜR RECHTSVERGLEICHUNG IN TEHERAN 1974, at 122, 124-29 (1974).

24. Aktiengesetz [AktG] § 291(1), 1965 Bundesgesetzblatt [BGBl] I 1089 (W. Ger.).

25. STAUDINGER-GROSSFELD, *supra* note 12, para. 168 (quoting Sandrock); *see also* MÜNCHKOMM-EBENROTH, *supra* note 22, para. 155; Soergel-Lüderitz, Vor Art. 7, Einführungsgesetz, BÜRGERLICHES GESETZBUCH, 8 KOHLHAMMER-KOMMENTAR, para. 210 (11th ed. 1983) [hereinafter SOERGEL-LÜDERITZ]. *But see, e.g.*, Soergel-Kegel, Art. 7, BÜRGERLICHES GESETZBUCH, 7 KOHLHAMMER-KOMMENTAR, para. 151 (10th ed. 1970), where a seat is defined as "the corporate headquarters at which the greatest number and most important decisions are regularly made." This definition is criticized in Sandrock, *Die multinationalen Korporationen im internationalen Privatrecht*, in INTERNATIONALRECHTLICHE PROBLEME MULTINATIONALER KORPORATIONEN 169, 181 n.17 (1978).

26. Famous examples include: Agfa-Gevaert, VFQ-Fokker, Royale Dutch-Shell, Unilever and Hoesch-Hoogovens. *See generally* G. GRASMANN, SYSTEM DES INTERNATIONALEN GESELLSCHAFTSRECHTS, paras. 371-79 (1970).

ory—that the state in which the corporate seat is located is the one most affected by its activities because more directors, officers, privileged shareholders and creditors would be domiciled there—proves unworkable in cases of subsidiaries of foreign parent companies, where most of the shareholders, directors and officers are usually domiciled outside the forum.[27]

Another criticism of the seat theory is that while it claims to protect the interests of the forum, it does not prevent the circumvention of statutes, even those with a very important social and political content, such as the German law on workers' co-determination.[28] This law provides for an equal number of shareholders' representatives on the one hand, and employees and union representatives on the other, on the supervisory board (Aufsichtsrat) of corporations whose number of employees exceeds two thousand.

The application of the co-determination law to groups of corporations, including both German and foreign companies, is one of the most actively disputed problems in German economic law.[29] Two different aspects of the problem should be distinguished: that concerning co-determination in a group of corporations in which the subsidiary is German and the parent company is located in a third country, and that where the parent is a German company. In the latter case, the debated questions are whether the employees of foreign subsidiaries have the right to elect

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27. *See* H.-G. KOPPENSTEINER, INTERNATIONALE UNTERNEHMEN IM DEUTSCHEN GESELLSCHAFTSRECHT 124 (1971); Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 53.

28. Gesetze über die Mitbestimmung der Arbeitnehmer, 1976 BGBl I 1153 (W. Ger.). *See generally* Vorbrugg, *Labor Participation in German Companies and Its European Context*, 11 INT'L LAW. 249 (1977).

29. *See* Däubler, *Mitbestimmung und Betriebsverfassung im internationalen Privatrecht*, 39 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT [RABELSZ] 444 (1975); Grasmann, *Internationale Probleme der Mitbestimmung*, 3 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 317 (1973); M. PRAGER, GRENZEN DER DEUTSCHEN MITBESTIMMUNG (INKLUSIVE BETRIEBSVERFASSUNG) IM DEUTSCH-SCHWEIZERISCHEN UNTERNEHMENSRECHT (1979); Birk, *Multinationale Unternehmen und internationales Arbeitsrecht*, in INTERNATIONALRECHTLICHE PROBLEME MULTINATIONALER KORPORATIONEN 263 (1978); Duden, *Zur Mitbestimmung in Konzernverhältnissen nach dem Mitbestimmungsgesetz*, 141 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT [ZHR] 145 (1977); Martens, *Mitbestimmung, Konzernbildung und Gesellschaftseinfluss, 138* ZHR 179 (1974); Bernstein & Koch, *Internationaler Konzern und deutsche Mitbestimmung*, 143 ZHR 522 (1979); H. VON ZITZEWITZ, DIE VEREINBARKEIT INTERNATIONALER VERTRAGSKONZERNE MIT DEM MITBESTIMMUNGSGESETZ 1976 (1980); Ebenroth & Sura, *Transnationale Unternehmen und deutsches Mitbestimmungsgesetz*, 144 ZHR 610 (1980).

and to be elected to the supervisory board of the German parent and, if not, whether they can be included in the total number of employees of the group for the purpose of activating the law.[30] These questions, however, are not highly relevant from the point of view of the applicability of the workers' participation law, since the law remains in effect even without the participation of employees working abroad when the numerical criterion is met by employees in Germany. The situation is different if the parent company and the German subsidiary have entered into a contract of domination under section 291(1) of the German Stock Corporation Law[31] because such a contract enables the parent to give binding orders to the board of directors of the subsidiary.[32] The board has the right to refuse the order only when it obviously runs contrary to the interests of the parent company or to the whole group.[33] Even where the parent's order meets objections from the supervisory board of the subsidiary, the order nevertheless can be implemented if the management of the parent repeats the order.[34]

The powers given to the parent company under section 308 would enable it to eliminate the co-determination rights of the subsidiary's employees with comparative ease. German commentators unwilling to accept this conclusion continue to react to contracts of domination in various ways. Thus, it is suggested *de lege ferenda* that section 308(3) should be modified to enable the supervisory board of the subsidiary to veto orders of the parent company[35] while it is argued *de lege lata* that contracts of domination between German subsidiaries and foreign parent corporations should be regarded as invalid as an infringement upon the national sovereignty of the Federal Republic of Germany and as an unreasonable restriction upon the rights of shareholders, creditors and employees of the subordinate company.[36] Some authors do not advocate the per se invalidity of contracts of domination with foreign parent companies, but only in circumstances where the workers' right to participate in the parent's management is not granted.[37] Finally, an alternative solution differing fundamentally from the aforementioned calls for a shift of

30. For an overview of the opinions expressed on this matter, see STAUDINGER-GROSSFELD, *supra* note 12, paras. 321-30.

31. AktG § 291(1), 1965 BGBl. I 1089.

32. AktG § 291(1).

33. § 308(1)-(2).

34. § 308(3).

35. Martens, *supra* note 29, at 194-95; H.-G. KOPPENSTEINER, *supra* note 27, at 250-51.

36. Däubler, *supra* note 29, at 468-73; C.T. EBENROTH, *supra* note 11, at 420-21.

37. Duden, *supra* note 29, at 186-89; Bernstein & Koch, *supra* note 29, at 531-36.

the methodology of Private International Law towards the theory of governmental interest-analysis. According to this concept, contracts of domination enabling the foreign parent to exclude co-determination are invalid since the German law expresses a policy of improving social welfare, a policy which Germany has an interest in effectuating notwithstanding the possiblity this policy would conflict with the divergent policy of a foreign state.[38]

Despite these objections, the majority view uses two arguments to reject the possibility of German workers participating in the management of the foreign parent company. First, the law governing the corporate affairs of the foreign parent company is not German and a cumulative application of different rules of law to the same situation would be impossible.[39] Second, the legislative intent, as derived from the provisions concerning groups of corporations, supports the validity of contracts of domination. In fact the legislators give preferential treatment with respect to the powers of the parent company to groups of corporations brought about by contracts of domination vis-à-vis de facto groups.[40] Thus, section 311 of the Stock Corporation Law provides that the controlling company of a de facto group must not use its influence so as to abuse or permit harm to be suffered by the other companies, nor cause them to enter into prejudicial transactions, unless the loss suffered is adequately compensated.[41] Both the parent company and its directors are liable for damages to the company which suffers the loss.[42] In addition, the management of the controlling company must submit a report to the supervisory board and the auditors (*Abschlussprüfer*) on the relations between this company and the other companies of the group.[43] These restrictions on de facto groups of companies are intended to make groups built on a contractual basis more attractive because they offer better protection to minority shareholder interests. A view excluding precisely this kind of association between German and foreign companies, therefore, would be inconsistent with the policy of the German legislation.

The consequence of recognizing the validity of domination contracts is that, with regard to worker co-determination, the seat theory is as powerless as the incorporation theory. If both theories achieve the same re-

38. *See generally* H. VON ZITZEWITZ, *supra* note 29, at 108-225.

39. *See* Ebenroth & Sura, *supra* note 29, at 620.

40. STAUDINGER-GROSSFELD, *supra* note 12, para. 403. For a short analysis of the status of these two types of affiliated companies, see, e.g., Zöllner, *Einführung in das Konzernrecht*, 8 JURISTISCHE SCHULUNG 297, 301-04 (1968).

41. AktG § 1311, 1965 BGBl I 1089.

42. AktG, §§ 317-18.

43. §§ 312, 316.

sult in an area as important as worker co-determination, is it necessary to impose the seat theory on foreign corporations, forcing them to incorporate under the law of the host state? While the seat theory is not responsible for the legislature's inadequacies, one substantial virtue of a theory which claims to be protective of the forum's interests would be its ability to enforce the vital policies of the forum notwithstanding the different foreign elements in each particular case. True, contracts of domination could be considered void and the co-determination provisions enforced under the principle of immediate application (*Sonderanknüpfung*).[44] That argument, however, could be used against supporters of the seat theory, who consider the inability to prevent circumvention of domestic law without help of rules of immediate application to be a serious disadvantage of the incorporation theory.[45]

The final criticism of the seat theory is the result it produces where the law of incorporation is not that of the state in which the seat is located. For instance, the seat theory regards as nonexistent corporations that transfer their seat outside the state of incorporation.[46] While advocates of the seat theory contend that this treatment offers satisfactory protection to creditors in the forum by holding the shareholders personally liable,[47] this treatment is hardly equivalent to corporate liability where the assets of the corporation are abroad and the shareholders have no assets in the forum.[48] Moreover, a judgment in the forum probably will not be recognized and enforced in a country that applies the incorporation theory and consequently views the corporation as an existent legal entity.[49] But even where there is co-operation between the state where the seat previously was established and the one to which the seat is to be transferred, with the former permitting the transfer without dissolution and liquidation and the latter recognizing the continuation of the corporation's existence under the condition that the corporation adapt

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44. Bernstein & Koch, *supra* note 29, at 532. For a general discussion of rules of immediate application, see Francescakis, *Lois d'application immédiate et droit du travail*, REVUE CRITIQUE DE DROIT INTERNATIONAL PRIVE 273 (1974); *see also* Zweigert, *Internationales Privatrecht und öffentliches Recht*, in FÜNFZIG JAHRE INSTITUT FÜR INTERNATIONALES RECHT AN DER UNIVERSITÄT KIEL 124 (1965).

45. *See* Ebenroth, *Unternehmensrecht und Internationales Privatrecht*, in FREIHEIT UND VERANTWORTUNG IM RECHT 101, 124 (1982).

46. *See* STAUDINGER-GROSSFELD, *supra* note 12, paras. 348-56; MÜNCHKOMM-EBENROTH, *supra* note 22, para. 180; *cf.* SOERGEL-LÜDERITZ, *supra* note 25, para. 242.

47. *See* C.T. EBENROTH, *supra* note 11, at 372-74.

48. STAUDINGER-GROSSFELD, *supra* note 12, para. 346.

49. *See* Sandrock, *supra* note 25, at 184.

its charter to the law of the new host state,[50] the seat transfer invariably involves a change in the law governing the corporation's activities. This means that a company incorporated in England and having a cause of action under English law against one of its shareholders, must bring the action under German law if it transfers its seat to Germany. The absurdity of this result[51] is evidenced by the refusal of some German courts to follow the seat theory in this respect.[52]

Similar problems do not arise under the incorporation theory. The principle of automatic recognition, the quintessence of this theory, not only guarantees business flexibility, but also provides corporate creditors with the continued existence of a legal entity against which their rights can be enforced.[53]

III. SUGGESTED ALTERNATIVES

A. *Incorporation and Effective Seat Theory Combined?*

Professor Wiedemann has suggested a potential resolution to the dilemma posed by the incorporation and seat doctrines.[54] His theory is directed at corporations within Member States of the European Community and is based on the formation of three groups of cases. The first consists of enterprises incorporated under the law of the forum state.[55] The law applicable to the corporate affairs of this group is forum law as long as the corporation maintains at least a registered seat in the forum. The rationale behind this proposal is that the forum's interests might be affected even where the effective seat is located in a third state. Its application allows the transfer of the effective seat out of the forum, without changing the law governing corporate affairs.

The second group encompasses enterprises incorporated under the law of an EC Member State.[56] Unlike the previous group, whose classifica-

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50. *See* Grossfeld, *Die Anerkennung der Rechtsfähigkeit juristischer Personen*, 31 RABELSZ 1, 35-36 (1967).

51. F.A. MANN, *Bemerkungen zum Internationalen Privatrecht der Aktiengesellschaft und des Konzerns*, in BEITRÄGE ZUM INTERNATIONALEN PRIVATRECHT 70, 72 (1976).

52. *See, e.g.*, Judgment of August 28, 1970, Oberlandesgericht, Hamburg, 16 AUSSENWIRTSCHAFTSDIENST DES BETRIEBS-BERATERS 518 (1970) (transfer of the corporate seat outside Germany without more is insufficient to make German law inapplicable).

53. *See* Vischer, *Die Wandlung des Gesellschaftsrechts zu einem Unternehmensrecht und die Konsequenzen für das internationale Privatrecht*, in INTERNATIONALES RECHT UND WIRTSCHAFTSORDNUNG 639, 646 (1977).

54. *See* Wiedemann, *supra* note 22, at 199-203.

55. *See id.* at 199-200.

56. *See id.* at 200-02.

tion was influenced by the principles of the seat theory, this group is founded on the incorporation theory: the law applicable to such corporations is that of the state of incorporation at least as long as there exists an "effective and durable connection"[57] between the corporate activities and the economy of one EC Member State.

Finally, the corporations forming the third group are those incorporated under a law of the state other than that of the forum or another EC Member State.[58] The law applicable to these cases initially depends upon whether any special clause in an international agreement provides for a solution. If not, the next inquiry is whether the corporation in question has its effective seat or its principal place of business in the forum. If so, the need for effective protection of the interests of shareholders, creditors and employees requires the application of forum law. If, however, the seat is located outside the forum, forum law yields to the law with which the corporation is more closely connected. In the latter case, "the incorporation principle can be applied without limitations."[59]

Despite Wiedemann's effort to treat different kinds of corporations separately, his concept does not really improve the theoretical basis of multinational corporation choice of law issues because it presents problems in all three groups of cases it distinguishes. In the first group, Wiedemann extends the applicability of forum law beyond the principles of the seat theory by applying forum law to cases in which an enterprise has done no more than register its seat in the forum. This replacement of the seat theory's real connection requirement with a legal connection requirement which is easily subject to manipulation, is likely to create conflict among states that follow Wiedemann's theory. Thus, if an enterprise is incorporated and has its registered seat in state A, but its effective seat and principal place of business is in state B, then the law governing its corporate affairs is the law of A. While state B, whose interests are probably more affected by the activities of the corporation, will be able to refuse to recognize the enterprise, dealing with a nonexistent legal entity will not advance the interests state B seeks to protect.

The treatment of the second group of cases reflects the need for legal harmonization within the European Community rather than the contemporary relations of the national laws of the Member-States. At present, the proposed solution would not lead to satisfactory results, as it would allow enterprises to circumvent the stricter law of one Member State

57. *Id.* at 201.
58. *See id.* at 202-03.
59. *Id.* at 203.

through incorporating in another.[60]

With respect to the third group, the theory does not define the meaning of the "principal place of business." It remains uncertain, therefore, whether the management seat, the site of the corporate activities or the domicile of the majority of shareholders, creditors or employees is determinative. It is fairly clear that this uncertainty may result in confusion with respect to the applicable law.[61]

B. Restricted Incorporation Theory

The failure of Wiedemann's case groups to fill the gap between the two competing theories implies the need for an alternative incorporation theory that reconciles the principle of automatic recognition with that of protection of the host state's vital interests. Well known legislative examples of "restricted" incorporation theories include the pseudo-foreign corporation laws of California[62] and New York[63] as well as the Convention between the Members of the European Community on the Mutual Recognition of Corporations and Legal Persons.[64] From an academic perspective, Grasmann's "theory of differentiation"[65] and Sandrock's "theory of super-addition"[66] probably are the most systematic attempts to modify the incorporation principle in favor of the policies of the forum.[67]

1. The Legislation

a. The United States Experience: California and New York

The dominance of the incorporation theory in the United States, which resulted in immunizing enterprises from the jurisdiction of any other state except that of incorporation, led to the "race of laxity," or

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60. *See* Ebenroth & Sura, *Das Problem der Annerkennung im internationalen Gesellschaftsrecht: Feststellung der Rechtsfähigkeit und Bestimmung der Personalstatus*, 43 RABELSZ 315, 328 (1979).

61. *Id.*; *see also MünchKomm-Ebenroth*, *supra* note 22, paras. 149-52.

62. *See infra* note 73-74 and accompanying text.

63. *See infra* note 75 and accompanying text.

64. *See infra* notes 76, 82-83 and accompanying text.

65. *See infra* notes 84-85 and accompanying text.

66. *See infra* notes 91-94 and accompanying text.

67. The recent trend in German scholarship towards the incorporation theory is noted in *MünchKomm-Ebenroth*, *supra* note 22, para. 117 & n.319. *See also* Westermann, *Das Gesellschaftsrecht in der Methodendiskussion um das internationale Privatrecht*, 4 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 68, 80 (1975).

"race for the bottom."[68] In order to attract enterprises so as to increase their charter fee revenues, most states tried to enact corporation laws that modeled the most lenient state laws then existing. Whenever a state introduced a less restrictive provision, other states would immediately follow. Although New Jersey initiated the race, Delaware, the contemporary "Mecca of American corporations," was the clear winner.[69]

Since the incorporation principle holds that the law of the state of incorporation governs the corporation's activities regardless of the degree of corporate contacts within such state, abuses of and reaction to state corporate law shopping were expected. On the federal level, the reaction came in the form of the 1933 Securities Act[70] and the 1934 Securities Exchange Act,[71] which regulate the issue and trading of securities and the dissemination of information by corporations, with the regulation of corporate affairs being left to the states. It is not astonishing, therefore, that California and New York, two of the nation's most heavily industrialized states, were the first to enact laws addressing the problems of pseudo-foreign corporations. In North Carolina a similar draft was prepared as early as 1955, but for reasons unknown it never became law.[72]

Section 2115(a) of the California Corporations Code provides that other selected sections will be applied to a foreign corporation if the average of "the property factor, the payroll factor and the sales factor . . . is more than 50 percent during its latest full income year, and if more than one-half of its outstanding voting securities are held of record by persons having addresses in [California]."[73] The most important of these selected provisions concern election and removal of directors, directors' standard of care and liability for unlawful distributions, shareholders' liability for receiving such distributions, indemnification of directors and officers, limitations on mergers and sale of assets, cumulative voting, re-

68. These famous appellations were introduced respectively by Justice Louis Brandeis in Liggett Co. v. Lee, 288 U.S. 517, 559 (1933) (dissenting opinion), and Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 666 (1974).

69. For a historical overview of this process, see R. NADER, M. GREEN & J. SELIGMAN, TAMING THE GIANT CORPORATION, 33-61 (1976). New Jersey was the original "Mecca for Corporations." *Id.* at 43.

70. Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended in scattered subsections of 15 U.S.C. §§ 77 & 78 (1982)).

71. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended in scattered subsections of 15 U.S.C. §§ 77 & 78 (1982 & Supp. III 1985)).

72. *See* Latty, Powers & Breckenridge, *The Proposed North Carolina Business Corporation Act*, 33 N.C.L. REV. 26 (1954).

73. CAL. CORP. CODE § 2115(a) (West 1977 & Supp. 1986).

organizations, dissenters' rights, records and reports, action by the Attorney General and rights of inspection.[74]

The New York Business Corporation Law[75] is founded on a different basis. It applies to all foreign corporations doing business in the state, with a partial exemption for those (1) whose shares are listed on a national securities exchange; or (2) whose business income allocable to the State of New York for franchise purposes is less than one-half its total business income. If a corporation meets either of these tests, then Section 1320 states that it need not comply with certain provisions concerning voting trust records, liabilities of directors and officers of the foreign corporation for failure to disclose required information and indemnification of directors and officers.

b. The Convention on the Mutual Recognition of Companies and Legal Persons[76]

Under Article 58 of the Treaty of Rome,[77] "[c]ompanies [or firms] constituted in accordance with the law of a Member State and having their registered office, central [administration] or [principal place of business] within the Community shall, for the purpose . . . of this Chapter, be [treated in the same way as] natural persons [who are] nationals of Member States."[78] An isolated reading of Article 58 seems to introduce the incorporation principle to corporations organized within the Community since the mere existence of a registered office in any Member State is enough for their recognition by all the others. However, read in the context of the chapter in which it is integrated, and to which it refers, Article 58 is actually less radical than it first appears. Thus, according to Article 52, the progressive abolition of restrictions on the freedom

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74. *See generally* Halloran & Hammer, *Section 2115 of the New California General Corporation Law — The Application of California Corporation Law to Foreign Corporations*, 23 UCLA L. REV. 1282 (1976); Note, *The Pseudo-Foreign Corporation in California*, 28 HASTINGS L.J. 119 (1976); Comment, *California's New General Corporation Law: Quasi-Foreign Corporations*, 7 PAC. L.J. 673 (1976).

75. *See* N.Y. BUS. CORP. LAW §§ 1300-20 (article on foreign corporations) & § 102(7) (definition of "Foreign corporation") (McKinney 1986); *see generally* Baraf, *The Foreign Corporation — A Problem in Choice-of-Law Doctrine*, 33 BROOKLYN L. REV. 219 (1967).

76. Convention on the Mutual Recognition of Companies and Legal Persons, Feb. 29, 1968, 12 BULL. E.E.C. Supp. (No. 2) (1969) [hereinafter Convention], *reprinted in* 3 Common Mkt. Rep. (CCH) ¶ 6255.

77. Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11 (unofficial English version) [hereinafter Treaty of Rome].

78. *Id.*, art. 58.

of establishment "shall also extend 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."[79] The meaning of the requirement of being already "established" in a Member State before one can claim the right of establishment has been defined in the "General Program for the Removal of Restrictions on the Right of Establishment."[80] For the purposes of Article 52 a corporation must have more than a registered office within the community; its business activity must evidence "a continuous and effective link with the economy of a Member State."[81]

Given the language of Article 58 and despite the limitation of Article 52, one is entitled to ask whether the application of the seat theory by the majority of Member States is compatible with Community law. The question is not of current interest since Article 58 is only a programmatic provision related to the coordination or approximation of national laws as expressed in Article 54(3) — an objective that obviously can be realized only gradually on a long-term basis. That was precisely the reason for drafting the Convention: the Member States felt that in the meantime a more liberal recognition practice was necessary.[82]

Although signed by the Ministers of Foreign Affairs on February 29, 1968, the Convention never has come into force because of the Netherlands' refusal to ratify it. The Convention's underlying concept is interesting, since it probably indicates the direction of development for Community conflict of laws in the area of corporations. That the Convention's philosophy does not differ much from the philosophy demonstrated by the California and New York legislatures is also interesting. According to Article 1, all companies, including cooperatives, must be recognized, without more, if they (1) are organized under the civil or commercial law of a state party to the Convention, and (2) if their registered seat is in a territory to which the Convention applies. Article 2 extends the Convention's coverage to all legal persons other than companies if their economic activity normally is performed for remuneration. So far it hardly can be disputed that the basis of recognition introduced by the Convention is the incorporation principle. However,

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79. *Id.*, art. 52.

80. 5 J.O. COMM. EUR. 36 (1962) (adopted by the Council of Ministers on Dec. 18, 1961).

81. *Id.*

82. STAUDINGER-GROSSFELD, *supra* note 12, paras. 91-92; Coester-Waltjen, *German Conflict Rules and the Multinational Enterprises*, 6 GA. J. INT'L & COMP. L. 197, 213-14 (1976); Stein, *Conflict-of-Laws Rules by Treaty: Recognition of Companies in a Regional Market*, 68 MICH. L. REV. 1327, 1335-36 (1970).

Articles 3 and 4 bring the seat theory into play. Article 3 enables each signatory to deny recognition to any corporation whose effective seat is outside the territories to which the Convention applies if the corporation does not maintain a genuine link with the economy of one such territory. Article 4, one of the most heavily criticized provisions of the Convention, represents the great concession to the seat theory. It permits a state to declare its mandatory law applicable to a corporation that is organized elsewhere but which has its effective seat within that state. The forum state even can apply its nonmandatory provisions if either the corporation's charter does not provide otherwise, or the corporation cannot prove that it has exercised its activity during a reasonable period of time in the state of incorporation. Under no circumstances, however, may the forum state refuse to recognize the corporation.[83]

2. The Scholarship

a. Grasmann's Theory of Differentiation[84]

In order to restrict the scope of application of the incorporation theory, Grasmann proposes a distinction between internal and external corporate affairs. While the former should be governed by the principle of the freedom of contract and should, therefore, be subjected to the law of the place of incorporation, the latter should be governed by the law of the place of business activity, since it is the most appropriate law for the protection of their parties dealing with the corporation. According to Grasmann's proposal, the organization of a corporation, its articles and bylaws, as well as the rights and duties of shareholders, belong to the internal affairs. Other issues including the raising and maintenance of capital, legal capacity, representation through corporate organs, and publicity are included in the external affairs.[85]

The main problem with Grasmann's differentiation theory is imple-

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83. *See, e.g.*, Beitzke, *Zur Anerkennung von Handelsgesellschaften im EWG-Bereich*, 14 AUSSENWIRTSCHAFTSDIENST DES BETRIEBS-BERATERS 91, 94 (1968); Drobnig, *Das EWG-Ubereinkommen über die Anerkennung von Gesellschaften und juristischen Personen*, 18 DIE AKTIENGESELLSCHAFT (pt. 1) 90, 96-97 (1973); Stein, *supra* note 82, at 1342-44.

84. *See generally* G. GRASMANN, *supra* note 26, paras. 615-1134.

85. Despite some differences as regards the distinction between "external" and "internal" affairs, the differentiation theory is similar to the concept that was advanced some years earlier by Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118 (1958). *See* G. GRASMANN, *supra* note 26, paras. 937-41 (discussing Reese & Kaufman, among others).

menting the differentiation requirement.[86] Differentiating corporate regulations that have to take into account a variety of legal relationships and then subjecting them to different legal orders will often be impossible. For instance, while an increase in capital alters the liability coverage of the corporation towards creditors, it simultaneously, from an internal standpoint, creates a means of shifting the balance of power within the shareholder group.[87]

In order to show the potential unsoundness of the classification of corporate affairs in one or the other category, Ehrenzweig[88] refers to the famous California case of *Western Air Lines v. Sobieski*.[89] A Delaware corporation that did a major portion of its business and had thirty percent of its shareholders living in California decided to eliminate cumulative voting so as to weaken the influence of its minority shareholders. The California Commissioner of Corporations found that because the corporation had substantial contacts with the state, including a significant number of shareholders, and the attempted change amounted to a sale of a security within the meaning of Section 25009 of the Corporate Securities Act,[90] he had jurisdiction to hold a hearing to determine the fairness of the proposed change in voting rights. The California Court of Appeals upheld the Commissioner's determination and decided that the corporation could not eliminate cumulative voting. Grasmann's theory would classify the change in voting rights from cumulative to straight as an internal matter that would be subjected to the personal law of the corporation. This case shows, however, that *a priori* differentiation can miss one of the theory's self-proclaimed goals to guarantee both domestic and foreign corporations the same amount of freedom.

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86. C.T. EBENROTH, *supra* note 11, at 365-67; MÜNCHKOMM-EBENROTH, *supra* note 22, paras. 145-48; Westermann, *supra* note 67, at 76-79; Hachenburg-Behrens, *Allgemeine Einleitung*, GESETZ BETREFFEND DIE GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG (GMBHG), 1 GROSSKOMMENTAR, para. 93 (7th ed. 1975) [hereinafter HACHENBURG-BEHRENS]; STAUDINGER-GROSSFELD, *supra* note 12, paras. 57-58.

87. 1 H. WIEDEMANN, *supra* note 20, at 789.

88. Ehrenzweig, Book Review, 35 RABELSZ 347, 348 (1971) (reviewing G. GRASMANN, *supra* note 26).

89. Western Air Lines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961).

90. Corporate Securities Act, ch. 384, § 1, 1949 Stat. 699, as amended by ch. 388 § 1, 1949 Stat. 729 (repealed by ch. 88, § 1, 1968 Stat. 243) (current equivalent at CAL. CORP. CODE § 25017 (West 1977 & Supp. 1986)).

b. Sandrock's Theory of Super-Addition[91]

Although Sandrock's theory of super-addition is fundamentally different from Grasmann's theory of differentiation, both theories advocate the applicability of two legal systems to the same corporation. In fact, the "theory of super-addition" is rooted in Latty's positions on pseudo-foreign corporations[92] and follows principally the regulatory scheme of the Convention on the Mutual Recognition of Companies and Legal Persons.[93] It distinguishes the law governing the incorporation of a domestic

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91. Sandrock, *supra* note 25, at 191-237; Sandrock, *Ein amerikanisches Lehrstück für das Kollisionsrecht der Kapitalgesellschaften*, 42 RABELSZ 227, 247-67 (1978); Sandrock, *Die Konkretisierung der Uberlagerungstheorie in einigen zentralen Einzelfragen*, in FESTSCHRIFT FÜR GÜNTHER BEITZKE ZUM 70. GEBURTSTAG 669 (O. Sandrock ed. 1979) [hereinafter Sandrock, *Die Konkretisierung*].

92. Latty, Pseudo-Foreign Corporations, 65 YALE L.J. 137 (1955).

93. See *supra* note 76. A number of legal commentators have expressed themselves in a similar fashion. Latty, for instance, was the first to draw the attention of state legislatures to the necessity of provisions for pseudo-foreign corporations and was himself one of the draftsmen of the proposed North Carolina Business Corporation Act provisions on the subject. See *supra* notes 72, 92. Baraf also welcomes state regulation of foreign corporations. See *supra* note 75. Hadari suggests a selective intervention in the internal affairs of foreign corporations with a rebuttable presumption in favor of the application of the law of the place of incorporation or of the registered seat. Hadari, *supra* note 17, at 42-49. Oldham, on the other hand, supports the enactment of pseudo-foreign corporation laws, including a choice of law provision stating that the internal affairs of all domestic corporations would be governed by forum law "unless the corporation satisfied the jurisdictional test of a reasonable pseudo-foreign corporations code of another state." Oldham, *Regulating the Regulators: Limitations Upon a State's Ability to Regulate Corporations with Multi-State Contacts*, 57 DEN. L.J. 345, 392 (1980) (emphasis omitted). Kaplan further distinguishes between genuine foreign, quasi-foreign and pseudo-foreign corporations. He thinks that host states should be able to apply their local law freely to the last type of foreign corporation. In cases of quasi-foreign corporations this freedom should be restrained and determined by the extent of substantial contacts with states other than the host state, while genuine foreign corporations should not be subject to host state law, "in the absence of an express statutory directive." Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 475 (1968). Finally, Behrens, although criticizing article 4 of the Convention for the problems its application would create, adopts in fact a quite similar position. The solution he proposes makes use of forum law whenever a corporation has its effective seat within the territory of the forum. In his opinion, the provisions should be broader than the *ordre public* clause of article 30 of the Introductory Law to the German Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch*), but at the same time they should be applied in a rather restrictive way to avoid imposing unnecessary burdens on the functions of foreign enterprises. *See* HACHENBURG-BEHRENS, *supra* note 86, para. 87.

In recent publications Professors Kozyris and DeMott have also argued for the restrictive application of forum law. *See* Kozyris, *supra* note 27; DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (Sum-

corporation and the recognition of a foreign corporation from the "personal law" of both, the "personal law" of a corporation being the law governing its internal affairs as well as its liability with regard to third parties. The former is always the law of the place of incorporation. The latter also is basically the law of incorporation. If the effective seat of the corporation is located outside the state of incorporation, however, this law might be superseded by the law of the host state if the creditors, including minority shareholders and all other persons having an immediate legal interest in the corporation (e.g., employees as regards their participation in the supervisory board), invoke the law of the host state because they consider it more favorable to them than the law of the incorporation. Thus, depending on the situation, the law applicable to the internal affairs of a foreign corporation is either the law of the state of incorporation or that of the host state. Both laws are never applicable concurrently to the same question.

In his discussion of the legitimacy of applying the law of the host state, Sandrock compares the concept of commercial domicile as used in the California and New York statutes with that of the effective seat as applied in continental Europe.[94] Considering the arguments brought against the California regulation, one might dispute the appropriateness of the criteria in Section 2115[95] as a basis for establishing legal certainty and predictability. As a corporation's business and capital structure fluctuate in and out of the lines drawn by the section's two tests, the applicable law can change annually, hindering not only corporate managers, shareholders and their counsel in planning the organization and conduct of corporate affairs, but also third persons who would be interested in doing business with the corporation.[96] Moreover, uncertainty about the law governing corporate affairs might linger for long periods of time[97] since disagreements as to the fulfillment of the tests are sometimes slow

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mer 1985). Kozyris favors only (a) the pseudo-foreign corporation and (b) the predominant-local-interests and no-genuine-link-with-place-of-incorporation and narrowest-possible-intervention exceptions. *See* Kozyris, *supra* note 27, at 57, 60-61, 63-65. According to Kozyris the "power of the [forum] . . . to interfere in hard core internal affairs ordinarily should be minimal." *Id.* at 97. Similarly, DeMott confines the application of local law provisions to "truly pseudo-foreign" corporations and applies only the provisions which implicate the interests of local creditors or which regulate isolated events and intrastate transactions. DeMott, *supra*, at 198.

94. Sandrock, *Die Konkretisierung*, *supra* note 91, at 688-93.

95. *See supra* note 73.

96. Halloran & Hammer, *supra* note 74, at 1288; Sandrock, *Die Konkretisierung*, *supra* note 91, at 674-75.

97. Halloran & Hammer, *supra* note 74, at 1283-84.

to surface, whether the disagreements are between different interest groups in the corporation or between the corporation and its creditors or the host state authorities. Problems might arise under the second test of Section 2115 where persons having a California address place their shares in trust with trustees that have no California address and who are not broker-dealers or nominees of a broker-dealer.[98]

The use of business income as the criterion for application of forum law in Section 1320 of the New York Business Law[99] can give rise to similarly erroneous conclusions whenever more than fifty percent of the income of a foreign controlled holding originated from a domestic corporation. In these cases, as well as in almost all cases involving multinational enterprises that realize the largest part of their income outside the state of incorporation, the law of the state in which the subsidiary is located will be applied to the corporate affairs of the foreign holding. The fact that the central administration of the holding is located in the state of incorporation is completely ignored.[100]

These reasons all support Sandrock's argument that the applicability of host state law should depend on whether a corporation has its effective seat in that state. However, the theory of super-addition does not use the effective seat notion to refer to the place at which the important policy directives are issued, but to the place at which these directives are transformed to "everyday administrative decisions."[101] This definition of the effective seat is the same one that has been adopted by German seat theorists who sought to legitimize the applicability of German law concerning groups of corporations to the relations between a German subsidiary and its foreign parent.[102] In the present context, the adoption of the above definition of the effective seat prevents the application of more than one foreign corporation statute to corporations managed by headquarters in more than one country.[103]

3. Evaluation

Although acceptance of the arguments against the California and New York regulations results in the exclusion of quantitative criteria in the application of host state law, it does not imply necessarily that the

98. *Id.* at 1285-86.

99. *See supra* note 75.

100. Sandrock, *Die Konkretisierung*, *supra* note 91, at 679.

101. Sandrock, *supra* note 25, at 238; Sandrock, *Die Konkretisierung*, *supra* note 91, at 683-84.

102. *See supra* notes 25-27 and accompanying text.

103. Sandrock, *Die Konkretisierung*, *supra* note 91, at 685-88.

scheme proposed by the theory of super-addition is not flawed. Both Article 4 of the Convention and this theory have been the subject of frequent criticism. On the one hand, "the prospect of living under two different company-law systems is fraught with so many uncertainties, particularly if the requirements of the two systems should not be compatible, that the affected company is likely to feel compelled to transfer its real seat to the state in which it was formed"[104] on the other hand, it is difficult to determine which provisions of host state law should apply to foreign corporations since in some instances there is no clear distinction between mandatory and optional provisions.[105]

While these concerns are undoubtedly legitimate, the decisiveness of their persuasive power is questionable. As Professor Kaplan points out in commenting on New York's regulation of foreign corporations:

> The contention of the *Restatement* and of other commentators that avoidance of confusion and difficulty makes it imperative to look to the law of the state of incorporation seems belied by the experience of New York. . . . So far as any published difficulty is concerned, it seems to have been minimal. In any event, the catastrophic results of dual corporate regulation which might otherwise be predicted do not seem to have occurred. Such regulation appears to have been viable for foreign corporations. Furthermore, there are extensive and sometimes conflicting dual controls, state and federal, at the present time in many corporate matters — primarily in the area of corporate internal affairs. . . . Although the existence of these duplicating and complementary controls . . . has created a situation of theoretical conflict, the practical results have been accepted and viable, and the duplication of controls has resulted not so much in conflict as in cumulative standards.[106]

Although life under two different legal orders might sometimes be difficult and although, unlike other areas of law that usually refer to past conduct, business law involves comprehensive and continuous planning, the difficulties nevertheless should not be exaggerated.[107] Corporate planners with advance knowledge of where the corporation will establish

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104. Stein, *supra* note 82, at 1344; *see also* Kozyris, *supra* note 27, at 49.

105. Stein, *supra* note 82, at 1343; Drobnig, *supra* note 83, at 97.

106. Kaplan, *supra* note 93, at 476-77 (footnote omitted).

107. It should not be overlooked that even German seat theorists who are particularly sensitive to the application of more than one law governing corporate affairs are ready to deviate from their principles in order to achieve better protection of the forum's interests. Thus, they advocate the application of German *Konzernrecht* to the relations between a foreign parent and a German subsidiary, thereby imposing on the former liabilities possibly not provided for in its own "personal law." *See supra* notes 22-27 and accompanying text.

or transfer its effective seat can prepare for the legal differences between home and host country, thereby avoiding "adventures" with local authorities that would be detrimental to their image. For example, corporations probably will be willing to include cumulative voting provisions in their charters or to adopt a corporate form allowing for employee co-determination if the corporation is required to do so by the host state.

The adoption of preventive measures would significantly limit potential conflicts, yet probably would not prove to be a highly reliable predictor of the applicability of host state law in each particular case. Predictability in business law, however, is a relative notion.[108] Corporations usually can predict only the "potential application" of a specific provision to a certain set of facts. Rarely can they predict whether, and to what extent, a court or public authority will enforce the law. This uncertainty is illustrated by antitrust regulation in the United States and Europe,[109] which often is couched in very broad language to account for the complexities of the market process. While broad statutory language has the advantage of covering a wide range of cases, it also makes it difficult for corporations to predict whether certain types of conduct will be regarded as violations. An example would be the difficulty a corporation would face in attempting to predict whether, in view of the variety of factors considered in determining a "dominant position" (market share, financial resources, vertical integration, ease of entry, potential competition etc.), the lack of precise criteria as to when a certain price is "abusive" and the interplay between "dominant position" and "abuse," a court would find its conduct abusive under Article 86 of the Treaty of Rome.[110] Another example would be the difficulty that parent companies have in predicting whether their joint venture will be considered a merger under Article 86, and not a cartel under Article 85.[111] Were the

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108. *See* C. JOERGES, ZUM FUNKTIONSWANDEL DES KOLLISIONSRECHTS 162-65 (1971); 1 H. WIEDEMANN, *supra* note 20, at 786.

109. *See* Wohlmann, *Rechtssicherheit und Kartellrecht*, 50 SCHWEIZERISCHE AKTIENGESELLSCHAFT 103 (1978).

110. Art. 86 provides in pertinent part: "Any abuse by one or more undertakings of a dominant position within the common market . . . shall be prohibited as incompatible in so far as it may affect trade between Member-States. [The article then proceeds to list examples of "abuse."] Treaty of Rome, *supra* note 77. For an illustration of the problems of Art. 86 of the Treaty of Rome, *see* Fuller, *Article 86 EEC: Economic Analysis of the Existence of a Dominant Position*, 4 EUR. L. REV. 423 (1979); Korah, *Concept of a Dominant Position within the Meaning of Article 86*, 17 COMMON MKT. L. REV. 395 (1980); Temple Lang, *Monopolisation and the Definition of "Abuse" of a Dominant Position Under Article 86 EEC Treaty*, 16 COMMON MKT. L. REV. 345 (1979).

111. For an introduction to the regulation of joint ventures under EEC-Competition

involved corporations not "surprised" when the Commission in *Continental Can*, applied Article 86 in such an expansive way so as to find that the acquisition of TDV by Europemballage Corporation, a Continental Can subsidiary, constituted abuse of Continental Can's dominant position in the Common Market?[112] Similarly, was Alcoa not "surprised" when Judge Hand characterized as monopolization the fact that Alcoa "anticipate[d] increases in the demand for ingot and [was] prepared to supply them."[113] Consider also the problems for corporate planners caused by the Department of Justice's power under Section 7 of the Clayton Act[114] to bring an action against a merger several years after its realization.

Businessmen understand that business is necessarily associated with risk. A corporation must accept a reduced degree of legal certainty if it is to risk doing business abroad — after all, its engagement in interstate or international commerce should not be regarded merely as means of maximizing profits. Of course, the adoption of the incorporation theory without restrictions would have the advantage of certainty and ease of application. But despite the desirability of these two features in the formation of legal principles, "there remains the question how big a price we want to pay for certainty when a rule giving us certainty leads to undesirable results."[115]

Corporations that overemphasize the need for legal certainty always have the alternative of establishing their effective seat in the state of incorporation.[116] Those that are willing to take the profit with the "legal risk" probably will be permitted to initiate informal procedures with the host state authorities in order to solve or avoid conflicts. On the other hand, host states can make efforts to limit the scope of application of forum law to foreign corporations. On this point, however, the contribution of the theory of super-addition is rather weak. It applies the forum's mandatory law, however defined, to a corporation having its seat in the forum, wherever parties with an interest in the corporation believe this law to be preferable to the law of incorporation.

Law, see U. HUBER & B. BÖRNER, GEMEINSCHAFTSUNTERNEHMEN IM DEUTSCHEN UND EURÖPAISCHEN WETTBEWERBSRECHT (1978); Ulmer, *Gemeinschaftsunternehmen im EG-Kartellrecht*, 29 WIRTSCHAFT UND WETTBEWERB 433 (1979).

112. Europemballage Corp. & Continental Can Co. v. EEC Commission, 1973 E. Comm. Ct. J. Rep. 215, 12 Comm. Mkt. L.R. 199 (1973).

113. United States v. Aluminum Co. of America, 148 F.2d 416, 431 (2d Cir. 1945).

114. Clayton Act, ch. 323, § 7, 38 Stat. 730, 731-32 (1914) (current version at 15 U.S.C. § 18 (1982 & Supp. III 1985)).

115. Latty, *supra* note 92, at 140; *see* Baraf, *supra* note 75, at 252.

116. Latty, *supra* note 92, at 173.

The concept of state regulation of foreign corporations, from Latty to the theory of super-addition, is intellectually proximate to Brainerd Currie's governmental interest-analysis.[117] It is probably not coincidental that California, in its eagerness to enforce a foreign corporation statute, is one of two United States jurisdictions that have adopted the interest-analysis test to resolve conflicts of law.[118] Except for a note in the *California Law Review* in 1962,[119] there have been no systematic attempts to apply Currie's theory to matters related to control of foreign corporations. The following section discusses whether standards for the limitation of forum law's scope of application can be derived from the general principles of interest-analysis.

IV. A Refined Interest-Analysis: The Second-Best Alternative?

Currie's governmental interest-analysis,[120] the catalyst of the modern "revolution" in choice of law in the United States and a source of inspiration for European reformers,[121] was in fact a "nihilist" view[122] of conflict of laws in the traditional sense. Currie saw interest-analysis as a reaction to the rigid rules of the first Restatement of Conflict of Laws.[123] Before presenting his theory, Currie stated "[w]e would be better off without choice-of-law rules." He believed that "Congress . . . [should] legislate . . . the choice between conflicting state interests in some of the specific areas in which the need for solutions is serious." Until then, he believed the best approach would be to look for a basic method to integrate "the teachings of sociological jurisprudence into the conceptualistic precincts of conflict of laws."[124] His method[125] begins by assuming that

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117. Baade, *Multinationale Gesellschaften im amerikanischen Kollisionsrecht*, 37 RabelsZ 5, 22 (1973).

118. For a survey of the choice of law theories adopted by each state, see Kay, *Theory into Practice; Choice of Law in the Courts*, 34 Mercer L. Rev. 521 (1983).

119. *See* Note, *Limited Liability of Shareholders in Real Estate Investment Trusts and the Conflict of Laws*, 50 Calif. L. Rev. 696 (1962); *see also* D. Klocke, Deutsches Konzernkollisionsrecht und seine Substitutionsprobleme (1974).

120. Currie developed his theory in a series of articles compiled in B. Currie, Selected Essays on the Conflict of Laws (1963) [hereinafter Selected Essays].

121. *See* C. Joerges, *supra* note 108; Gutzwiller, *Von Ziel und Methode des IPR*, 25 Schweizerisches Jahrbuch für Internationales Recht 161 (1968); Rehbinder, *Zur Politisierung des Internationalen Privatrechts*, 28 Juristenzeitung 151 (1973); *see generally*, *The Influence of Modern American Conflicts Theories on European Law*, 30 Am. J. Comp. L. 1 (1982) (international colloquium).

122. E. Scoles & P. Hay, Conflict of Laws 16 (1982).

123. Restatement of Conflicts of Laws (1934).

124. B. Currie, *Notes on Methods and Objectives in the Conflicts of Law*, in Se-

the court should apply forum law, even to cases involving foreign elements. Where the court is asked to apply a law other than that of the forum, it should inquire into the policies expressed in these laws, employing the ordinary processes of construction and interpretation. If the court finds that only one state has an interest[126] in the application of its policy in the circumstances of the case, it should apply the law of the interested state. If the court finds an apparent conflict in the legislative interests of the two states, it first should attempt to avoid a conflict by a moderate and restrained interpretation. If, even upon reconsideration, the court finds that a conflict between the interests of the two states is unavoidable, it should apply the forum's law. Likewise, if an unavoidable conflict exists between the laws of two other states and the court cannot, with justice, decline to adjudicate the case, it should apply the law of the forum.

Perhaps the main characteristic of the interest-analysis is its homeward trend whenever a true conflict exists which cannot be resolved by restrained interpretation. Currie viewed "the forum's courts as the judicial arm of state government, empowered to effectuate in private litigation the community values and state policies set out in earlier cases or established by the executive or legislator."[127] For this reason, Currie directed forum states to advance their policies and interests where a conflict exists with claims of other states; intentionally excluding a "weighing" of the competing interests approach. According to Currie, "assessment of the respective values of the competing legitimate interests of two sovereign states, in order to determine which is to prevail, is a political function of a very high order. This is a function that should not be committed to courts in a democracy."[128]

The similarities between the interest-analysis and the super-addition concept are obvious: both apply forum law when the interests of the forum are in conflict with interests of a foreign state. However, the prerequisites for the application of forum law differ. Under the super-addition

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LECTED ESSAYS, *supra* note 120, at 177, 183.

125. For a summary of the late B. Currie's view, *see Comments on* Babcock v. Jackson, *A Recent Development in Conflicts of Laws*, 63 COLUM. L. REV. 1212, 1242-43 (1963) (comments by several scholars; Currie's begins on p. 1233).

126. For a definition of the term "interest" as used in the interest-analysis theory, see B. CURRIE, *The Verdict of Quiescent Years*, in SELECTED ESSAYS, *supra* note 120, at 584, 621.

127. Kay, *The Use of Comparative Impairment to Resolve True Conflicts: An Evaluation of the California Experience*, 68 CALIF. L. REV. 577, 612 (1980).

128. B. CURRIE, *supra* note 124, at 182; *see also* B. CURRIE, *supra* note 126, at 599-609.

theory, host state law can be invoked in the state where a foreign corporation has its effective seat. On the other hand, the California and New York laws apply where a company transacts a certain amount of business in the forum. By contrast, Currie's method does not require such prerequisites, for "[u]nder the Constitution, the power of a state to apply its law in conflicts situations depends not on . . . formalistic and adventitious 'contacts,' but upon whether the state has a legitimate interest in the application of its policy."[129] He emphasized that references to such contacts were inadmissible in the "weighing" of conflicting interests since they " 'casually defeat now the one and now the other policy, depending on a purely fortuitous circumstance.' "[130] This criticism only partly applies to the California and New York statutes because the legislature of these states asserted that their interest in displacing foreign standards arises only where foreign corporations have "preponderant contacts" with the forum.[131]

The theories differ where there is no foreign corporations statute. While location of the effective seat is one of the "connecting factors" for the potential application of forum law, interest-analysis advocates giving the forum the choice of applying its law where it has a legitimate interest in the subject matter. Currie's only precondition for the enforcement of the forum's interest is that its courts have jurisdiction over a foreign corporation. Since the rule of *International Shoe* states that jurisdiction exists if the defendant has "certain minimum contacts with [the forum] such that the maintenance of a suit does not offend 'traditional notions of fair play and substantial justice,' "[132] every state in which a foreign corporation is doing business can apply its law to the corporation's affairs. This, however, goes too far. It creates the "legal spaghetti" which Halloran and Hammer feared in California[133] and practically eliminates predictability as to which law governs corporate affairs. Therefore, the effective seat alternative is preferable.[134]

Once the court has found a prima facie conflict exists between the interests of the involved states, the interest-analysis approach directs the

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129. B. CURRIE, *Unconstitutional Discrimination in the Conflict of Laws: Privileges and Immunities*, in SELECTED ESSAYS, *supra* note 120, at 445, 485.

130. B. CURRIE, *supra* note 126, at 607 (quoting SELECTED ESSAYS, *supra* note 120, at 120).

131. Baraf, *supra* note 75, at 249 (referring to the N.Y. law).

132. International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945) (quoting Milliken v. Meyer, 311 U.S. 457, 463 (1940)).

133. Halloran & Hammer, *supra* note 74, at 1288.

134. For further discussion of this problem, *see infra* notes 163-66 and accompanying text.

court to inquire as to whether each state has a possible interest or policy which would be advanced by the application of its own law. At this stage, Currie suggests that true conflicts should be avoided through "restraint and enlightenment in the determination of what state policy is and where state interests lie" and cites as an example Nebraska's case law on foreign small-loan contracts.[135] Although Nebraska's highest court initially held that foreign contracts with interest rates above the limit set in the Nebraska small-loan act were unenforceable,[136] it later reversed itself and recognized as valid contracts governed by foreign laws " 'similar in principle' " to the Nebraska statute.[137]

Sandrock's theory of super-addition does not propose a more moderate and restrained interpretation. Wherever forum law is involved, however, super-addition implies that where co-determination is an issue, the court should determine whether the management decision of a foreign corporation would have been different if the law governing the corporate affairs had been that of the forum. If the decision would have been different, it should be regarded as void.[138] This hypothetical comparison certainly sounds rather "adventurous," but it demonstrates the super-addition theory's willingness to accept compromises.

Should the court prove unsuccessful in its attempt to avoid a conflict by a moderate and restrained statutory interpretation, both theories apply forum law. If this were the last step in choosing which law governs the corporate affairs of a foreign company, the contribution of interest-analysis in limiting the scope of application of forum law would be worthless. But Currie's teachings have been successfully refined by Professor Baxter,[139] expanded by Professor Horowitz,[140] and adopted, sub-

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135. B. CURRIE, *supra* note 124, at 186. For a criticial analysis of Currie's step of "moderate and restrained interpretation," *see* Kanowitz, *Comparative Impairment and Better Law: Grand Illusions in the Conflict of Laws*, 30 HASTINGS L.J. 255, 268-73 (1978).

136. B. CURRIE, *supra* note 124, at 186; *see* Personal Finance Co. of Council Bluffs v. Gilinsky Fruit Co., 127 Neb. 450, 255 N.W. 558 (1934), *cert. denied*, 293 U.S. 627 (1935).

137. B. CURRIE, *supra* note 124, at 186; *see* Kinney Loan & Finance Co. v. Sumner, 159 Neb. 57, 65 N.W.2d 240 (1954). Currie characterizes *Kinney Loan* as a repudiation by the court of its prior rigid interpretation of state policy, B. CURRIE at 186, but in fact the court had little choice. After *Gilinsky* was decided the legislature repealed the old law and adopted a new statute containing the "similar in principle" exception. *Kinney Loan & Finance Co.*, 159 Neb. at 62-63, 65 N.W.2d at 245-46.

138. Sandrock, *supra* note 25, at 229-34.

139. *See generally* Baxter, *Choice of Law and the Federal System*, 16 STAN. L. REV. 1 (1963).

140. *See generally* Horowitz, *The Law of Choice of Law in California — A Restate-*

ject to criticism regarding the correctness of its application, relatively recently by the California Supreme Court,[141] as the theory of comparative impairment.

Baxter contends that the analysis that Currie uses to distinguish "real" from "false" conflicts[142] cases also could be applied to reduce and resolve real conflicts. Under this concept:

> The question "Will the social objective underlying the X rule be furthered by the application of the rule in cases like the present one?" need not necessarily be answered "Yes" or "No"; the answer will often be, "Yes, to some extent." The extent to which the purpose underlying a rule will be furthered by application or impaired by nonapplication to cases of a particular category may be regarded as the measure of the rule's pertinence and of the state's interest in the rule's application to cases within the category. Normative resolution of real conflicts cases is possible where one of the assertedly applicable rules is more pertinent to the case than the competing rule.[143]

Although the subordination of the external objective of the state to the internal objective which will be impaired least in the particular case involves some weighing of interests, Baxter argues that this kind of judicial determination is very different from the super-value-judgments rejected by Currie and should, therefore, be considered legitimate.[144] Horowitz also supports this position and distinguishes between searching for the law that "manifest[s] the 'better' or the 'worthier' social policy on the specific issue" and "accommodat[ing] conflicting state policies . . . [by] allocating the domains of law-making power in multistate contexts." In his view, the " 'political question' aspects" of the latter are minimized since the balancing does not attempt to evaluate the wisdom of the conflicting policies.[145]

Since the comparative impairment method reflects natural-law premises as opposed to Currie's legal positivism, it can be argued that the choice is, "in the final analysis, a question of a clash of faiths."[146] But is

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ment, 21 UCLA L. REV. 719 (1974).

141. Bernhard v. Harrah's Club, 16 Cal. 3d 313, 546 P.2d 719, 128 Cal. Rptr. 215, *cert. denied*, 429 U.S. 859 (1976); Offshore Rental Co. v. Continental Oil Co., 22 Cal. 3d 157, 583 P.2d 721, 148 Cal. Rptr. 867 (1978). For an overview of the cases which lower courts decided on the basis of the comparative impairment method, *see* Kay, *supra* note 127, at 591-603.

142. *See generally* Comment, *False Conflicts*, 55 CAL. L. REV. 74 (1967).

143. Baxter, *supra* note 139, at 9.

144. *Id.* at 18-19.

145. Horowitz, *supra* note 140, at 753.

146. Kanowitz, *supra* note 135, at 293.

it necessary to go so far where there are good arguments for the comparative-impairment modification of the interest-analysis? If applied on a reciprocal basis, this method will advance every state's policies because each state will be prepared to trade undesired areas of control for desired ones.[147] It also will improve predictability by preventing the forum-shopping which the "orthodox" interest-analysis makes possible through the rigid application of forum law in every real conflict case.[148] Another important reason for adopting the comparative-impairment method can be derived from the "philosophies" that underlie this method and Currie's approach as the two are related to the choice of law problems governing the corporate affairs of foreign companies. Professor Kay, who adheres to interest-analysis, argues choice of law cases should not seek "to answer . . . 'whose law is to be applied?' " but " 'under what circumstances is a departure from local law justified?' "[149] However, the incorporation theory starts from a different point. Basically, it applies the law of incorporation, making an exception in favor of forum law wherever a foreign corporation has its seat in the forum and the application of forum law will advance domestic policies significantly. To combine the restricted incorporation concept with Currie's approach would be a contradiction, and would disturb the rule-exception balance upon which this concept is based. The comparative-impairment modification, however, does fit into the restricted incorporation concept. It qualifies the strong homeward trend of "orthodox" interest-analysis by attempting to keep the application of forum law within the limits of an exception.[150]

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147. Baxter, *supra* note 139, at 10. Professor Martin expresses doubts about the workability of this model by asking whether the forum would not be better off if it adhered to interest-analysis while its neighbors adhere to comparative impairment. J. MARTIN, CONFLICT OF LAWS 240 (2d ed. 1984). In the short run, it is certainly true that the benefits to the forum from the adoption of such a tactic would be greater. The question, however, is how long the forum could afford, on the one hand, to apply its own law blindly in every true conflict case, and, on the other hand, to expect its neighbors to sacrifice their own weak interests in a spirit of international comity.

148. *See* Baxter, *supra* note 139, at 9-10, 19-22. On the contrary, no argument against Currie's version could be based on the contention that it also balances interests to a certain extent when it tries to avoid true conflicts through "moderate and restrained interpretation." Such an argument would be persuasive only if Currie advocated a moderate and restrained interpretation of both the domestic and the competing foreign law. *See* E. SCOLES & P. HAY, *supra* note 122, at 18 & n.10. But the correct reading of Currie's position seems to be that a forum's courts "interpret only their own law in this manner." Kanowitz, *supra* note 135, at 269; *see also* R. CRAMTON, D. CURRIE & H. KAY, CONFLICT OF LAWS 272 (3d ed. 1981).

149. Kay, *supra* note 127, at 617.

150. It should perhaps be mentioned that the value of the comparative-impairment

The comparative-impairment modification herein advocated follows essentially the Baxter-Horowitz model, not the expansive interpretation preferred by the California Supreme Court in *Offshore Rental.*[151] In this case, the plaintiff, a California corporation, sent its vice-president to Louisiana to confer with the representatives of Continental Oil, a Delaware corporation, about the lease of oil drilling equipment. While on the defendant's premises in Louisiana, the plaintiff's vice-president was injured as a result of the defendant's employees' negligent conduct. Although the defendant compensated the vice-president for his injuries, the plaintiff sued in California to recover damages occasioned by the loss of its "key-employee's" services.[152] California law, Section 49 of the California Civil Code and dicta in various California cases presumably give a master a cause of action against a third party for negligent injury to his key-employee.[153] By contrast, Louisiana law determines that the cause of action applies only to "indentured servants, apprentices and others who are bound in the service of an individual for a specific period of time."[154] Louisiana's policy "is predicated on the view that allowing recovery [for loss of key-employee's services] would lead to 'undesirable social and legal consequences.' "[155]

After it found that there was a true conflict between the law of Louisiana and the law of California, the court tried to resolve it by applying the method of comparative-impairment, abandoning the step of "moderate and restrained interpretation" of forum law. The court quoted Baxter and Horowitz approvingly, yet chose to adopt the view of von Mehren and Trautman, which examines the strength with which the state's policy is executed.[156] To support this view the court cited Professor

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principle is appreciated to a certain extent even by supporters of "orthodox" interest-analysis. Thus, Professor Sedler notes that the aspects of this principle "relate[d] to avoiding true conflict, rather than to resolving it, may be useful in determining whether the policy behind the forum's rule will be significantly advanced by its application in the particular case." Sedler, *The Governmental Interest Approach to Choice of Law: An Analysis and a Reformulation*, 25 UCLA L. REV. 181, 222 n.235 (1977).

151. *Offshore Rental Co. v. Continental Oil Co.*, 22 Cal. 3d 157, 583 P.2d 721, 148 Cal. Rptr. 867 (1978).

152. *Id.* at 160-61, 583 P.2d at 723, 148 Cal. Rptr. at 869.

153. *Id.* at 162 & nn.3-4, 583 P.2d at 724 & nn.3-4, 148 Cal. Rptr. at 870 & nn.3-4.

154. Bonfanti Indus. v. Teke, Inc., 224 So. 2d 15, 17 (La. App.), *aff'd*, 254 La. 779, 226 So. 2d 770 (1969).

155. *Offshore Rental*, 22 Cal. 3d at 163, 583 P.2d at 725, 148 Cal. Rptr. at 871 (quoting *Bonfanti*, 224 So. 2d at 17).

156. *Id.* at 165, 583 P.2d at 726, 148 Cal. Rptr. at 872; *see* A. VON MEHREN & D. TRAUTMAN, THE LAW OF MULTISTATE PROBLEMS 377 (1965).

Freund who contended that " '[i]f one of the competing laws is archaic and isolated in the context of the laws of the federal union, [the law] may not unreasonably have to yield to the more prevalent and progressive law, other factors of choice being roughly equal.' "[157] The court applied these criteria and concluded that California's policy was not strongly carried out because California had demonstrated little interest in applying Section 49 to the employer-employee relationship and its statute was "unusual," "outmoded," and inconsistent with the "main stream" of United States jurisdictions.[158] This finding, combined with the facts that the accident occurred within Louisiana's borders and that California's policy could be satisfied by means other than enforcement of the statute itself (i.e., insurance), led the court to decide that Louisiana law should govern the case because its interests would be more impaired if its law were not applied.[159]

In applying the comparative-impairment method, the *Offshore Rental* court considered factors that partly went beyond the scope of this method as originally formulated by Professor Baxter. In fact, the passage in Freund's article upon which the court based its determination of the strength of local policy was cited by Baxter himself as an example of an impermissible super-value-judgment.[160] It is certainly true that when a court refuses to apply a state law because it considers it "unusual," "outmoded," or out of harmony with the "main stream" of other state jurisdictions, it is evaluating the "quality" of the state policies. The state has the right to adopt the policies, whether archaic or progressive, that it regards as appropriate and to rely upon the court to effectuate them.[161] Distinguishing "progressive" policies from "archaic" policies is not an objective determination to which all states will agree. Moreover, the problems arising from such an evaluation are obviously more serious once the multistate context becomes multinational.

On the other hand, the "desuetude" criterion does not seem to be objectionable. As long as the court's refusal to apply a certain law does not

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157. 22 Cal. 3d at 165, 583 P.2d at 726, 148 Cal. Rptr. at 872 (quoting Freund, *Chief Justice Stone and the Conflict of Laws*, 59 HARV. L. REV. 1210, 1216 (1945) (emphasis omitted)).

158. 22 Cal. 3d at 167-68, 583 P.2d at 727-28, 148 Cal. Rptr. at 873-74.

159. *Id.* at 167-69, 583 P.2d at 727-29, 148 Cal. Rptr. 873-75.

160. *See* Baxter, *supra* note 139, at 18 & n.39.

161. B. CURRIE, *Survival of Actions: Adjudication versus Automation in the Conflicts of Laws*, in SELECTED ESSAYS, *supra* note 120, at 128, 143-44; Kanowitz, *supra* note 135, at 298 (quoting SELECTED ESSAYS, *supra* note 120, at 143-44); *see also* Reppy, *Eclecticism in Choice of Law: Hybrid Method or Mishmash?*, 34 MERCER L. REV. 645, 674 (1983).

result from its lack of opportunity to effectuate the law, but from its willingness to reach the desirable outcome in another way, the court can legitimately conclude that the policy behind that law is no longer strongly held. In such cases, the intensity of a state's interest in effectuating its policies is not judged by "objective" standards but by the state's own conduct.

As far as other factors considered by the court are concerned, there can be no question about the compatibility of the "comparative pertinence" criterion ("[t]he more closely a case resembles a 'core' application of the statute — the more the case presents an instance of just the kind of problem at which the statute was directed — the greater the state's interest in its application")[162] since it was developed by Baxter himself.[163] On the contrary, Currie considered the location of the legal relationship to be a "fortuitous circumstance" which should not influence the choice of law process.[164] Currie's position could be attacked as contradictory because it advocates the location of the effective seat as a "connecting factor" for the potential application of forum law while it rejects the use of territorial contacts within the comparative-impairment analysis. However, this contraindication is only apparent, since the seat's location does not determine which law is applicable to corporate affairs, but only activates the mechanism of interest-analysis and the comparative-impairment method that determines the choice of law question. Once this mechanism has started operating, the state interests, not the location of the seat, decide the matter.[165] It also is arguable that territorial contacts assist in determining which state's policy would be more impaired by

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162. Note, *Comparative Impairment Reformed: Rethinking State Interests in the Conflict of Laws*, 95 HARV. L. REV. 1079, 1098 (1982).

163. Baxter, *supra* note 139, at 12. *Compare* Baxter's view *with* Horowitz, *supra* note 140, at 753 (emphasis on the "appropriate scope of conflicting state policies"). *See also* Reppy, *supra* note 161, at 673-74 (discussing the use of comparative pertinence in *Offshore Rental*).

164. *See supra* text accompanying note 130; *compare* Note, *supra* note 162, at 1099 (supporting a territorial contacts analysis) *with* Reppy, *supra* note 161, at 674-76 (criticizing territorialism).

165. For the same reason, it is not a contradiction to advocate the adoption of the seat-criterion in the present conflict while criticizing it within the scope of the seat theory. *See supra* note 27 and accompanying text. When the latter insists on applying to corporate affairs the law of the state in which the seat is located, although this state is not the most affected by the corporate activities, it usually applies a law for which there is — according to its own criteria — no legitimation. Here, however, the situation is completely different: if the court determines that the host state's interests are not the interests most affected, it simply applies incorporation law. The shortcomings of the seat-criterion are compensated by the method of comparative-impairment.

nonapplication of its own law. For instance, the interest of the state of incorporation will be less impaired by nonapplication of its law to a corporation with no in-state contacts than by nonapplication to a corporation that is doing substantial business there. The fallacy of this argument is readily apparent from a brief observation of Delaware's experience. Delaware's policy is to offer corporations extensive liberties without any concurrent obligations to maintain contact with the state of incorporation, thereby enriching itself by attracting charter fees from foreign businessmen. It is evident that Delaware has an interest "in keeping the merchandise nice and shiny so that they can continue to sell it."[166] However parasitic this policy might be, one could not seriously dispute that it is an affirmative policy[167] whose impairment is independent of territorial contacts.

Finally, it has been suggested that a court using the comparative-impairment method, in contrast with the interest-analysis method, should not only consider the specific policies underlying the laws at issue, but also make sure that the application of the laws would be in accord with the states' so-called "systemic policies." These are the same policies that a court considers when it interprets disputed law in domestic cases, including fairness to outsiders, "facilitation of multistate transactions, and encouragement of interstate travel."[168] One response that underestimates the validity of these remarks poses questions such as: "These lofty concerns have a pleasant sound, but do they assist in the decision of concrete cases? How and when should they be applied? How much weight do they deserve as against the more specific policies of the forum's otherwise-applicable domestic rule?"[169] The other response is to acknowledge the need to recognize "systemic" policies but to subordinate these policies to a consideration of the interests reflected in the substantive laws of the involved states.[170] After all, the workability of the comparative-impairment principle is largely dependent upon more general policies, such as reciprocity.

In sum, each time the interest-analysis approach finds the forum state has a real interest in applying its own law to the corporate affairs of a foreign company with its seat in the forum, the comparative-impairment

166. Ratner & Schwartz, *The Impact of* Shaffer v. Heitner *on the Substantive Law of Corporations*, 45 BROOKLYN L. REV. 641, 673 (1979).

167. *See* J. MARTIN, *supra* note 147, at 230; *see also* R. CRAMTON, D. CURRIE & H. KAY, *supra* note 148, at 264.

168. Note, *supra* note 162, at 1098-99 (footnotes omitted).

169. R. CRAMTON, D. CURRIE & H. KAY, *supra* note 148, at 297.

170. Sedler, *supra* note 150, at 193-94.

method should try to avoid or resolve true conflicts by examining the intensity of each state's interest in having its policy prevail, the comparative pertinence of the legislative concern to the particular case and, to a lesser degree, the "systemic" policies of the states involved. That is, of course, not a *numerus clausus* of issues that courts have to examine in order to ascertain which state's interests would be more impaired by nonapplication of its own law. Other issues could be added by the courts as their experience with the comparative-impairment method grows. Questions such as whether a particular protective feature could be legally circumvented by a domestic corporation, whether the policy expressed by the specific law is unusual or innovative, and whether this law has an enabling or imperative character (but see once again Delaware's example)[171] could, but need not, assist the court's analysis. More important are matters such as the functional impact of the application of forum law to foreign corporations, i.e., whether thereby the validity of a single transaction or of the whole corporate mechanism is affected, as well as the amenability of the corporate affairs in question to differential treatment.[172]

In any event, Dean Latty's suggestion in his aforementioned article concerning pseudo-foreign corporations should be seriously considered within the comparative-impairment analysis. Latty tries to keep the applicability of forum law in limits, contending that "[n]ot . . . all local strong-policy protective features need be applied to all pseudo-foreign corporations. Instead, they need be applied only when the interests sought to be protected thereby are predominantly local interests."[173] In his opinion, the application of local law should depend on a majority rule:

> [I]f most of the shareholders (or maybe even most of the *minority* shareholders outside the management group) are local residents, the local requirement for cumulative voting might be applied at the request of the local shareholders. . . . On the other hand, if local interests do not predominate, they might well be left to take their chances, along with the predominantly foreign [shareholders], with the provisions of the law of the state of incorporation. . . .[174]

Recall that Section 2115 of the California Corporation Code was criticized because, *inter alia*, its second test (more than one-half of the outstanding voting securities must be held by persons having addresses in

171. *See supra* notes 166-67 and accompanying text.
172. *See* DeMott, *supra* note 93, at 198; Kozyris, *supra* note 27, at 63-65.
173. Latty, *supra* note 92, at 161.
174. *Id.*

California) could be circumvented by placing the shares in trust with trustees having no California address.[175] In an international context the replacement of "local residents" with "nationals of the forum state" would reduce similar dangers. In fact, Latty's proposal in this modified form seems to "fit" well in the comparative-impairment concept. Thus, if a corporation were to have its seat in Germany and 95% of its shares were owned by a foreign holding, under the theory of super-addition, a portion of the shareholders representing the remaining 5% could choose to apply German law whenever this law seemed more favorable to them. In this situation, the forum's interests probably would not be significantly impaired by the nonapplication of its own law. In a similar situation in which the foreign parent controlled "only" 70% and the rest were spread among nationals of the forum, should not the shareholder representing 0.5% of the stock be able to invoke forum law even when the majority shareholders and the "majority of the minority" think that the law of incorporation is more favorable to their interests? When should the 0.5% stockholder be able to impose his will over the 99.5%? Does this solution not contradict the fundamental principles of corporate democracy?

Latty's suggestion similarly could be extended to workers' co-determinations, by making this law applicable only if the majority of workers were nationals of the forum. Apart from the fact that such a regulation would not find ready acceptance because of the socio-political importance of the co-determination law, however, the problem probably would not arise very often since the vast majority of the employees of a corporation are usually nationals of the state in which the effective seat is located. Finally, any rule relating the degree of impairment of a state policy to the relative size of the interest group affected by a certain corporate measure should be limited in cases not involving interests of local third parties such as corporate creditors.[176] The critics of Grasmann's theory have shown that sometimes it will be impossible to distinguish between internal and external corporate affairs,[177] and no attempt is made here to revitalize it. This means that the majority principle should apply only to members of an affected interest group within the corporation in their capacity as such.

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175. *See supra* note 98 and accompanying text.

176. *See* DeMott, *supra* note 93, at 198.

177. *See supra* note 86.

V. CONCLUSION

The seat theory suffers from theoretical and practical weaknesses. Its problems arising from nonrecognition, in conjunction with the progressive unification of national markets in the European Community, suggest the need for an alternative theory that is based on the principles of the theory of incorporation while simultaneously offering effective protection of the host state's interests. The application of interest-analysis combined with the method of comparative-impairment and the criterion of the seat-location offers a satisfactory solution. Its rules are less rigid, its scope of application narrower, and its results more reliable than those of the theory of super-addition. Moreover, the suggested method does not operate with mechanical and legalistic rules "appropriate for the relationship at issue," focusing instead on the state policies expressed in the laws involved, and the extent of their impairment by nonapplication. It does not need the "patches" of the "principles of immediate application" to enforce the forum's policies in situations like the one arising from "contracts of domination." Under this method, a court which finds that nonapplication of the co-domination statute will significantly impair the forum's interests simply will declare the contract of domination void.[178] A foreign parent will not be allowed to circumvent the policies of the forum, just as a domestic parent company would not be allowed to do so.[179]

Although life under two different legal orders may sometimes create difficulties for corporations, consistent application of the suggested choice of law method will increase predictability about the applicable law and thus limit conflicts to sporadic exceptions. Nevertheless, if a corporation overemphasizes the need for certainty, it always has the alternative of incorporating at home. While the combination of interest-analysis and comparative-impairment is certainly a "second best" solution, to reject it for this reason would be to forget that the search for "the best" can be the worst enemy of accepting the good.

The last question raised in the introduction, whether Public and Private International Law approaches to multinational enterprises are alternatives, is not difficult to answer:

> The corporation of today is no longer policed solely by the traditional means of control provided by private corporate law; what is more, there are numerous legal, economic, social and political devices and methods for

178. *Cf. supra* notes 38, 44-45 and accompanying text (discussing the voiding of contracts of domination).

179. *See* Sedler, *supra* note 150, at 227.

> control of corporate power. Securities laws, control through the stock market, control by public agencies, employee participation as well as financial accounting and reporting are but a few significant examples.[180]

The increasing presence of the state in the economic process as regulator and/or participant "leads to the necessary consequence that international private law follows more and more the patterns of public international practice. Therefore, the student of Conflict of Laws is compelled to become a trespasser into the field of public international law."[181] In fact, the adoption of the proposed approach, by analyzing governmental interests, diminishes the distinction between and calls for the interaction of Public and Private International Law.

In the area of Public International Law, national standards of regulation of corporate activities have been harmonized through "codes of conduct."[182] The language of the codes often is the result of difficult compromises and usually is very broad. Consequently, the fields of law for which codes already have been elaborated are rather limited, and deficiencies have had to be covered with the help of Private International Law.[183] Codes, by setting standards of international economic cooperation and business ethics, constitute elements of an international "ordre public" that could be of substantial assistance for the choice of law in cases in which the interests of two states in applying their own policies are in conflict.[184]

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180. Grossfeld & Ebke, *Controlling the Modern Corporation: A Comparative View of Corporate Power in the United States and Europe*, 26 AM. J. COMP. L. 397, 433 (1978); *cf.* Kozyris, *supra* note 27, at 93-96 (suggesting a role for both approaches).

181. H. KRONSTEIN, THE LEGAL RELATIONSHIP BETWEEN AMERICAN PARENT CORPORATIONS AND THEIR FOREIGN SUBSIDIARIES 104 (1940).

182. For an overview of existing and proposed codes and guidelines, see Vagts, *Multinational Corporations and International Guidelines*, 18 COMMON MKT. L. REV. 463 (1981); Wallace, *International Codes and Guidelines for Multinational Enterprises: Update and Selected Issues*, 17 INT'L LAW. 435 (1983).

183. *See* von Caemmerer, *Rechtsvereinheitlichung und internationales Privatrecht*, in PROBLEME DES EUROPÄISCHEN RECHTS 63, 90-91 (1966); J. KROPHOLLER, INTERNATIONALES EINHEITSRECHT 183-213 (1975).

184. Horn, *Die Entwicklung des internationalen Wirtschaftsrechts durch Verhaltensrichtlinien*, 44 RABELSZ 423, 447-48, 452 (1980).