# *The Internal Affairs Doctrine – Rights and Duties of Shareholders, Directors, and Officers of Foreign Corporations Doing Business in Michigan*

By Bruce L. Segal

As of October 2006, there were a total of 20,725 foreign profit corporations registered to do business in Michigan,[1] including approximately 83 public companies that identify themselves as having their headquarters or principal place of business in Michigan.[2] Logically, the rights and duties of the shareholders, directors, and officers of these foreign corporations should be governed by the laws of the states in which they are incorporated. But this is not a universal truth,[3] and, in Michigan, this conclusion is not as straightforward as it could be.

Many states have adopted a provision of the Model Business Corporation Act, which provides that the business corporation act "'does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state.'"[4] Michigan, however, is not one of them.

Under the Michigan Business Corporation Act (BCA), foreign corporations that receive a certificate of authority have the same rights and privileges as domestic corporations.[5] Moreover, except as otherwise provided in the BCA, these corporations are also subject to the same duties, restrictions, penalties, and liabilities imposed on domestic corporations.[6] However, this does not necessarily mean that the *internal* affairs of these foreign corporations—that is, the rights and duties of the shareholders, directors, and officers in relation to the corporation—are also governed by the BCA.[7] Rather, it appears that the law applicable to the internal affairs of foreign corporations headquartered in Michigan is determined by common law principles, most notably, the "internal affairs doctrine."

The internal affairs doctrine "is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders – because otherwise a corporation could be faced with conflicting demands."[8] Under this doctrine, the local law of the state of incorporation is applied to determine issues that "involve the 'internal affairs' of a corporation – that is the relations inter se of the corporation, its shareholders, directors, officers or agents."[9] "Application of that body of law achieves the need for certainty and predictability of result while generally protecting the justified expectations of parties with interests in the corporation."[10]

As explained in the Restatement (Second) of Conflict of Laws, the internal affairs doctrine favors the needs of interstate and international business systems and promotes certainty, predictability, and uniformity, as well as protecting the justified expectations of the parties:

> Uniform treatment of directors, officers and shareholders is an important objective which can only be attained by having the rights and liabilities of those persons with respect to the corporation governed by a single law. To the extent that they think about the matter, these persons would usually expect that their rights and duties with respect to the corporation would be determined by the local law of the state of incorporation. This state is also easy to identify, and thus the value of ease of application is attained when the local law of this state is applied.[11]

In this regard, the United States Supreme Court has noted that the internal affairs doctrine also has its basis in contract law:

> When, by acquisition of his stock, plaintiff became a member of the corporation, he, like every other shareholder, impliedly agreed that in respect of its internal affairs the company was to be governed by the laws of the State in which it was organized.[12]

This is consistent with Michigan law, which recognizes that "[t]he relation between a corporation and its stockholders is contractual in its nature."[13]

The internal affairs doctrine has constitutional underpinnings, as well:

> The internal affairs doctrine is not, however, only a conflicts of law principle. Pursuant to the Fourteenth Amendment Due Process Clause, directors and officers of corporations "have a significant right . . . to know what law will be applied to their actions" and "stockholders . . . have a right to know by what standards of accountability they may hold those managing the corporation's business and affairs." Under the Commerce Clause, a state "has no interest in regulating the internal affairs of foreign corporations." Therefore, this Court has held that an "application of the internal affairs doctrine is mandated by constitutional principles, except in the 'rarest situations,'" *e.g.*, when "the law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce."[14]

Michigan courts have not explicitly adopted the internal affairs doctrine. They have, however, followed the Restatement (Second) of Conflict of Laws in addressing choice of law issues in other contexts.[15] Moreover, the Supreme Court of Michigan has expressly recognized, albeit in the jurisdictional context, the need for judicial restraint in addressing the internal affairs of a foreign corporation.[16]

In *Wojtczak v. American United Life Ins. Co.*, the plaintiff sought to restrain the defendant's performance under a reinsurance management contract, under which the defendant reinsured and assumed, with certain limitations, the policy obligations of a Michigan insurance corporation.[17] The defendant was a mutual life insurance corporation authorized to do business in Michigan but organized under the laws of the state of Indiana and with its headquarters and principal place of business in Indiana.[18] The lower court dismissed the plaintiff's bill of complaint on jurisdictional grounds, and the Supreme Court of Michigan affirmed, holding that "[i]f the restraint sought undertakes to exercise control or management of the internal affairs of defendant, a foreign corporation, the courts of this State will not assume jurisdiction."[19]

As the court explained:

> It has long been settled doctrine that a court -- State or Federal -- sitting in one State will as a general rule decline to interfere with or control by injunction or otherwise the management of the internal affairs of a corporation organized under the laws of another State but will leave controversies as to such matters to the courts of the State of the domicile.[20]

Moreover, the court made it clear that this rule applies

> even at the suit of a resident stockholder, and even though the corporation may be doing business in the State or country and may have expressly or impliedly agreed to submit to the jurisdiction of the court in suits against it, and has a substantial portion or even all of its tangible property in the State and is for all practical purposes a local corporation except as to the place of its creation.[21]

Finally, addressing what it meant by the phrase "internal affairs," the court explained:

> [W]here the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders' meeting, or through its agents, the board of directors, that then such action is the management of the internal affairs of the corporation, and in case of a foreign corporation, our courts will not take jurisdiction.[22]

The *Wojtczak* court, by declining jurisdiction, sidestepped actual acceptance of the internal affairs doctrine. Nevertheless, leading commentators in Michigan rely on this decision as a clear indication that the BCA

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does not govern the internal affairs of foreign corporations.[23]

This conclusion is buttressed by a recent decision of the Supreme Court of Delaware in *Vantagepoint Venture Partners 1996 v. Examen, Inc*.[24] The Michigan courts commonly refer to Delaware law for guidance on issues of corporate law,[25] and, as the Delaware court confirmed "[i]t is now well established that only the law of the state of incorporation governs and determines issues relating to a corporation's internal affairs."[26]

## Conclusion

Neither the BCA nor the Michigan courts have expressly adopted the internal affairs doctrine. Nevertheless, there is ample support for the conclusion that the rights and duties of the shareholders, directors, and officers of foreign corporations headquartered in Michigan are determined by the laws of their states of incorporation and not by the BCA or Michigan common law.

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## NOTES

1. *See* http://www.michigan.gov/cis/0,1607,7-154-35299_35413-114907--,00.html.

2. *See* Global Securities Information, Inc., LIVEDGAR, http://www.gsionline.com/, last updated Nov. 10, 2006).

3. Some states apply their own corporate laws to foreign companies. *See* 1 F. Hodge O'Neal & Robert B. Thompson, *O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 2:13* (2006), citing Cal. Corp. Code § 2115 (West 2006) (specifying sections of California Corporation Code applicable to foreign corporations whose shares are not publicly traded); N.Y. Bus. Corp. Law §1315 (McKinney 2006) ( right to inspect list of shareholders of foreign corporations); *id.* at § 1317 (imposing, for certain actions, liability on, and permitting actions against, directors of foreign corporations to the same extent as directors of domestic corporations); *Jefferson Indus. Bank v. First Golden Bancorporation,* 762 P.2d 768 (Colo. Ct. App. 1988) (Delaware corporation headquartered in Colorado subject to Colorado laws regarding shareholder inspection of corporate records); *Application of Dohring,* 142 Misc.2d 429, 537 N.Y.S.2d 767 (N.Y. Sup. Ct. 1989) (allowing minority oppression suit against Delaware corporation to proceed under New York statutory and common law).

4. *See* 1 *O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 2:13* (quoting Model Bus. Corp. Act § 15.05(c)).

5. MCL § 450.2002.

6. *Id.*

7. *See* Stephen H. Schulman, Cyril Moscow, and Margo Rogers Lesser, *Michigan Corporation Law & Practice* §§ 10.2, at 353 (Aspen Publishers 1996-2005, 2006, 2007) ("The courts, however, will generally not interfere with the internal affairs or management of a foreign corporation.") (citing *Wojtczak v. American United Life Ins. Co.,* 293 Mich. 449, 292 N.W. 364 (1940)). *See also id.* at §§ 7A.2, 7B.2 & n. 62. There are, however, certain sections of the BCA that specifically apply to foreign corporations. *See, e.g.,* MCL § 450.1491a(a) (defining, for purposes of sections 491a to 497 of the BCA, "[d]erivative proceeding" as "a civil suit in the right of a domestic corporation or a foreign corporation that is authorized to or does transact business in this state").

8. *Edgar v. MITE Corp.,* 457 U.S. 624, 645 (1982).

9. *Restatement (Second) of Conflict of Laws* § 302(2) & cmt. a (1971). At least one commentator suggests that the internal affairs doctrine should not necessarily apply to contracts between individual shareholders that involve the corporation only tangentally or not at all, such as with transfer restrictions or buyout agreements. *See* 1 *O'Neal and Thompson's Close Corporations and LLCs: Law and Practice* § 7:9.

10. *First Nat. City Bank v. Banco Para El Comercio Exterior de Cuba,* 462 U.S. 611, 621 (1983) (*citing Restatement (Second) of Conflict of Laws* § 302, cmts a, e (1971)).

11. *Restatement (Second) of Conflict of Laws* § 302(2), cmt. e; *see also id.* cmt. g.

12. *Rogers v. Guaranty Trust Co. of New York*, 288 U.S. 123, 130 (1933).

13. *Voigt v. Remick*, 260 Mich. 198, 204, 244 N.W. 446, 449 (1932).

14. *Vantagepoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005) (ellipses in original) (footnotes omitted).

15. *See, e.g., Chrysler Corp. v. Skyline Indus. Servs., Inc.,* 448 Mich. 113, 125, 528 N.W.2d 698, 703 (1995) ("It is sufficient to say that the concerns for certainty and public policy expressed in the Second Restatement reflect sound considerations that may guide a court in resolving specific conflicts between the contract laws of different states."); *Martino v. Cottman Transmission Sys., Inc.*, 218 Mich. App. 54, 60, 554 N.W.2d 17, 21 (1996) (recognizing that the Supreme Court of Michigan has "adopted, as guidelines," sections of the Restatement (Second) of Conflict of Laws).

16. *See Wojtczak v. American United Life Ins. Co.*, 293 Mich. 449, 451, 292 N.W. 364, 365 (1940).

17. *Id.* at 450-51, 292 N.W. at 365.

18. *Id.* at 450, 292 N.W. at 365.

19. *Id.* at 451, 292 N.W. at 365.

20. *Id.* at 452, 292 N.W. at 365 (quoting *Rogers v. Guaranty Trust Co. of New York,* 288 U.S. 123, 130 (1933)).

21. *Id.* at 452, 292 N.W. at 366 (quoting 17 William Meade Fletcher, *Fletcher Cyclopedia of the Law of Corporations* § 8425, at 368 (Perm. Ed.)).

22. *Id.* at 453-54, 292 N.W. at 365 (quoting *North State Copper & Gold Mining Co. v. Field,* 64 Md. 151, 154, 20 A. 1039, 1040 (1885)).

23. *See supra* n. 7. As noted in *Fletcher Cyclopedia of the Law of Corporations*, the courts no longer consider the question to be one of jurisdiction or power but rather "a question of discretion in the court as to whether to exercise jurisdiction." 17 William Meade Fletcher, *Fletcher Cyclopedia of the Law of Corporations* § 8425, at 405 (rev. ed. 2006).

24. 871 A.2d 1108, 1113 (Del. 2005).

25. *See Glancy v. Taubman Ctrs., Inc.*, 373 F.3d 656, 674 n.16 (6th Cir. 2004) ("In the absence of clear Michigan law on matters of corporate law, Michigan courts often refer to Delaware law."); *In re Consumers Power Co. Derivative Litig.,* 132 F.R.D. 455, 461 (E.D. Mich. 1990) (same); Michigan Corporation Law & Practice § 1.4, at 9 ("For issues outside the [Michigan Business Corporation Act], especially those pertaining to large or publicly held corporations, the courts frequently look to Delaware because of its large body of decisional law.").

26. 871 A.2d at 1113. In *Vantagepoint,* the Delaware court explicitly rejected the notion that a California statute could dictate the internal affairs of a corporation incorporated under the laws of the State of Delaware.

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