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Diversity Jurisdiction: Erie Amenability of a Foreign Corporation to Federal Court Derivative Suit

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enforce a tax lien to federal courts, is apparently not as clear-cut as it would appear on the surface, for Justice Hallows, in his dissent in *Monday,* stated that he believed the *O'Connor* rule applies to state courts as well as federal courts. Justice Hallows also found no implied exclusion of a state court's jurisdiction, as the majority did, nor any anomaly in according to the Wisconsin court the power to decide this issue. He argued that the United States sought this result when it applied to the state court for enforcement of a lien against money in its custody.[61]

Actually, the holding of the majority seems reasonable in light of the federal statutes and the apparent anomaly of a state court overriding a federal officer's determination based on federal law. Should Justice Hallows' view be adopted, additional problems would arise concerning the extent of a state court's jurisdiction; for example: would jurisdiction be limited to those cases in which the court held assets of the taxpayer? In any event, it appears that it will take a federal statute or at least a federal court decision stating expressly that a state court has the power to determine the validity of a federal tax assessment on its merits before Justice Hallows' view is followed in Wisconsin.

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Diversity Jurisdiction: Erie Amenability of a Foreign Corporation to Federal Court Derivative Suit: In *Lapides v. Doner*[1] a minority stockholder of the DWG Cigar Corporation, incorporated in Ohio, and three of the corporate directors brought a diversity derivative suit in United States District Court for the Eastern District of Michigan against five directors and the corporation seeking a declaration that resolutions adopted at a meeting of the board of directors were void. The resolutions included the replacement of the plaintiffs with the individual defendants on the board of directors and the executive committee.

Since under *Wojtczak v. American United Ins. Co.*,[2] the Michigan courts would not assume jurisdiction over an action involving the exercise of control or management of the internal affairs of a foreign corporation, the case hinged on whether the *Erie*[3] doctrine, as developed by later cases[4] required the district court to apply the Michigan rule. Thus, the ultimate problem was whether the Michigan rule, as expressed

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[61] P. C. Monday Tea Co. v. Milwaukee County Expressway Comm'n., 29 Wis.2d 372, 383, 139 N.W.2d 26, 32 (1966).

[1] 248 F.Supp. 883 (1965).

[2] 293 Mich. 449, 292 N.W. 364 (1940).

[3] Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938), Federal Courts in diversity matters must apply the substantive law of the state wherein the cause of action occurred, and federal procedural law.

[4] Guaranty Trust Co., v. York, 326 U.S. 99 (1945); Byrd v. Blue Ridge Rural Electric Coop., Inc., 356 U.S. 525 (1958).

in *Wojtczak,* was a rule of substantive or procedural law. Neither party disputed the proposition that the court must follow the rule in *Wojtczak* if a rule of substantive law was involved.

The decision by the *Lapides* court that the *Wojtczak* rule need not be followed, ostensibly on the basis that it was a local rule of *forum non conveniens* and thus subject to "procedural" classification under *Erie* terminology, makes necessary a brief analysis of the much traveled road of *Erie.*

The ultimate problem which *Erie* considered was the diversity issue necessarily attendant upon a federal system of government: whether federal or state law should be applied in diversity cases. In overruling *Swift v. Tyson,*[5] and destroying the concept of federal common law, *Erie* set up an allegedly simple dichotomy of substance and procedure, the inadequacy of which was recognized early.[6] The mechanical substantive-procedural test was supplemented in a subsequent decision, *Guaranty Trust Co. v. York,*[7] which held that whenever the application of a federal procedural rule would significantly affect the result of litigation in a federal court, the rule is considered to be substantive and state law applies. Although the *Guaranty* test limited the primary inducement to forum shopping, its literal rule was neither practically nor constitutionally feasible, since, in effect, the federal court in diversity cases tended to become only "another court of the state."[8] Though tempered somewhat by the "countervailing federal considerations" of *Byrd v. Blue Ridge Electric Coop., Inc.,*[9] the *Guaranty* test continued to set the pace.[10]

In fact, the Court of Appeals in *every* circuit which has considered the problem has applied state law in determining the amenability of a foreign corporation to service of process by federal courts in diversity cases.[11] The leading case of *Ragan v. Merchants Transfer and Ware-*

[5] 41 U.S. (16 Pet.) 1 (1842).

[6] Tunks, *Categorization and Federalism: "Substance"* and *"Procedure"* after *Erie Railroad v. Tompkins,* 34 ILL. L. REV. 271, 301 (1939).

[7] 326 U.S. 99 (1945).

[8] *Id.* at 108.

[9] 356 U.S. 525 (1958).

[10] Among the decisions upholding a literal interpretation of Guaranty Trust: Angel v. Bullington, 330 U.S. 183 (1947), the Federal Court must follow state law and policy in diversity jurisdiction; Woods v. Interstate Realty Co., 337 U.S. 535 (1949), reaffirming Angel; Arrowsmith v. United Press International, 320 F.2d 219 (2d Cir. 1963), state law is controlling as to amenability to service of process in a diversity case.

[11] Pulson v. American Rolling Mill Co., 170 F.2d 193 (1st Cir. 1948), Waltham Precision Instr. Co. v. McDonnell Aircraft Corp., 310 F.2d 20 (1st Cir. 1962); Partin v. Michaels Art Bronze Co., 202 F.2d 541 (3rd Cir. 1953); Stanga v. McCormick Shipping Corp., 268 F.2d 544 (5th Cir. 1959); New York Times Co. v. Conner, 291 F.2d 492 (5th Cir. 1961), Lone Star Motor Import, Inc. v. Citroen Cars Corp., 288 F.2d 69 (5th Cir. 1961); Canvas Fabricators, Inc. v. William E. Hooper and Sons Co., 199 F.2d 485 (7th Cir. 1952); National Gas Appliance Corp. v. AB Electrolux, 270 F.2d 472 (7th Cir. 1959), cert. denied, 361 U.S. 959 (1960); Electrical Equipment Co. v. Daniel Hamm Drayage Co.,

house Co.[12] solidified this line. The *Ragan* court, in a diversity suit beset by conflicting rules of service of process, held that the court looked to local law to determine not only the primary elements of the cause of action, but also the precise procedures by which the running of a local statute of limitations against such an action could be interrupted. Accordingly, it was held that the filing of the complaint in federal court under Rule 3 was insufficient to "commence an action" within the meaning of a state statute requiring service of the summons to interrupt the running of the (substantive) statute of limitations.

The effect of the "not every vagrant effect" limitation of a recent case, *Hanna v. Plumer*,[13] is not certain; but the *Lapides* court evidently presumed that *Hanna* overruled *Ragan*. *Hanna* held that Federal Rule 4(d)(1), rather than state law, governed service of process in a diversity case, even though the effect of the holding was to give a different result in federal court than in state court. However, *Sylvester v. Messler*,[14] and *Groninger v. Davison*,[15] concluded that *Hanna* did *not* overrule *Ragan*. *Groninger*, like *Ragan*, was a diversity suit for damages suffered in an accident which occurred less than two years before filing of the complaint but more than two years before the summons was served. The *Groninger* court held that it was controlled by *Ragan*, and that the suit was barred by Iowa's two-year statute of limitations. In spite of Federal Rule 3, which provides that "a civil action is commenced by filing a complaint with the court," the *Groninger* decision insisted that the action could not be commenced under the Iowa rule by the filing of a complaint. Furthermore,

> "While it is difficult to reconcile *Hanna* with *Ragan*, we nevertheless must conclude that the majority of the Supreme Court, in supporting the opinion written by the Chief Justice, felt it was *not an overruling of Ragan. Until the Supreme Court itself overrules its very positive statements in Ragan, the lower courts must follow its holdings.*"[16] (Emphasis added.)

That *Hanna* may not stand for what the *Lapides* court thought it did has ramifications in the *Lapides* opinion, since *Hanna* played a significant role therein. The court bases its holding on three cases:

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217 F.2d 656 (8th Cir. 1954); Ark-La Feed and Fertilizer Co. v. Marco Chemical Co., 292 F.2d 197 (8th Cir. 1961); Steinway v. Majestic Amusement Co., 179 F.2d 681 (10th Cir. 1949).

[12] 337 U.S. 530 (1949).

[13] 380 U.S. 460 (1965).

[14] 246 F.Supp. 1 (E.D. Mich. 1964), Aff'd. 351 F.2d 472 (1965).

[15] 35 U.S.L. WEEK 2129 (U.S. Aug. 26, 1966).

[16] This quote undoubtedly was made tongue in cheek, in order to prompt a Supreme Court pronouncement on the precise issue of whether *Hanna* overruled *Ragan*. Express overruling of its own prior decisions has never been the penchant of the Court. The Groninger statement that "Until The Supreme Court itself overrules . . . the lower courts must follow" is not a proper application of precedent; and would seem to be an attempt to bait the court into making such an express pronouncement.

Williams v. Green Bay and Western Railroad Co.,[17] *Koster v. Lumbermens Mutual Casualty Co.*,[18] and *Hanna.* The court first considers *Weiss v. Routh*,[19] which held that the *Erie* doctrine required application of state law in refusing to assume jurisdiction over a case involving the internal affairs of a foreign corporation and then attempts to distinguish the *Lapides* facts. The *Weiss* court based its holding on two premises: (1) Unless it followed state law, it had no guidelines for the exercise of discretion in deciding whether to accept or refuse jurisdiction; and (2) The outcome of litigation should not be changed when brought in a federal court rather than in a state court. The *Lapides* court refuted the first theory by stating that both *Williams* and *Koster* established guidelines, namely the *forum non conveniens* principles of convenience, efficiency, and justice; and that both courts had indicated that, *if* compelled to decide the question at issue here, they would hold that federal courts are *not* obliged to follow a state rule declining jurisdiction in cases involving the internal affairs of foreign corporations. The second theory is held to have been answered by *Hanna,* whose scope is doubtful as previously considered.

It is submitted, however, that the real basis of the *Lapides* decision is to be found in a line of cases, discussed in *Hanna v. Plumer,* based on federal statutes, irrespective of the substantive or procedural earmarking called for by *Erie.* Significantly, this second line of cases was dealt with in the original *Erie* opinion by Mr. Justice Brandeis. Since there are federal venue statutes dealing with this precise matter,[20] the more forceful argument can be made that federal law must apply irrespective of the *Erie* principle. In considering the applicability of these statutes to *Lapides,* the fundamental scope of *Erie* must be examined. The following is from Mr. Justice Brandeis' majority opinion: *"Except in matters governed by the Federal Constitution or by Acts of Congress,* the law to be applied in any case is the Law of the States."[21] (Emphasis added.)

Hence the paramount question: "Is the question of jurisdiction of the internal affairs of a foreign corporation by a federal district court in a diversity case decided by the Federal Constitution or by an Act of Congress?"

In characterizing the *Wojtczak* rule as a local rule of *forum non conveniens,* a characterization which seems to have been amply supported,[22] an affirmative answer must follow, for the federal laws of

[17] 326 U.S. 549 (1946).
[18] 330 U.S. 518 (1947).
[19] 149 F.2d 193 (2d Cir. 1945).
[20] 28 U.S.C. §1404(a) (1958); 28 U.S.C. §1401 (1958).
[21] Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938).
[22] Williams v. Green Bay and Western Railroad Co., 326 U.S. 549 (1946); Rogers v. Guaranty Trust Co., 288 U.S. 123 (1933); Willis v. Weil Pump Co., 222 F.2d 261 (2d Cir. 1955).

venue plainly include the general area of *forum non conveniens.* 28 U.S.C.§ 1404(a) provides:

> "For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought."

That section 1404(a) governs the general area of *forum non conveniens* is stated in strong language in several recent decisions of the Court.[23]

Furthermore, 28 U.S.C.§ 1401, applicable to stockholder's derivative actions, provides that "any civil action by a stockholder on behalf of his corporation may be prosecuted in any judicial district where the corporation might have sued the same defendant." Since the DWG Cigar Corporation could have sued the same defendants in Michigan because of their residence there, it is clear that venue was properly in Michigan under section 1401.

Thus we need only develop the syllogism envisioned in the *Erie* opinion itself. *Erie* held that federal courts in diversity cases must apply state law "except in matters governed by the Federal Constitution or by Acts of Congress." Since questions of *forum non conveniens* are governed in the federal courts by an Act of Congress, sections 1404(a) and 1401, the federal courts need not follow state rules of *forum non conveniens* in diversity cases. Carried one step further, since the *Wojtczak* rule is a *state* rule of *forum non conveniens,* it need not be followed by the *Lapides* court in this diversity action.

With the previous discussion of *Hanna v. Plumer* in mind, it is evident that the heart of *Lapides* is in the line of cases which resolve conflicts of rule on the basis of an existing federal statue.[24]

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[23] Norwood v. Kirkpatrick, 349 U.S. 29 (1955); Willis v. Weil Pump Co., supra note 22; Gilbert v. Gulf Oil Corp., 153 F.2d 883 (2d Cir. 1946). Regarding policy developments in the field of internal affairs of a foreign corporation, RESTATEMENT (Second), CONFLICT OF LAWS §117e, comment d at 69 (Tent. Draft No. 4, 1957) states:

> "Internal affairs of foreign corporation. At one time, it was customary for the courts to evince strong reluctance to interfere with the 'internal affairs' of a corporation that had been incorporated in another state. On this basis, stockholders' suits against foreign corporations were frequently dismissed in situations where the alleged wrong affected plaintiff solely in his capacity as a member of the corporation. This doctrine enjoys less force at the present time. The fact that the suit involves the internal affairs of a foreign corporation is held by the courts today to be but one of the factors to be considered in determining whether the forum selected is an appropriate one for the suit. This factor, moreover, will rarely be of crucial significance unless the nature of the relief demanded would require the court to exercise detailed and continued supervision over the corporation's affairs."

[24] *Hanna itself* was based on the federal statute line. In *Hanna,* the Supreme Court for the *first* time was faced with a direct conflict between state law and the federal rules. In vigorously upholding the federal rules, the court very carefully made this distinction between the two lines of cases previously considered, before basing its decision on the Rules Enabling Act, 28 U.S.C. §2072 (1958). The *Hanna* decision was directly opposed to the conclusion which

It would seem that *Lapides* and *Hanna* are indicative of the trend toward a continuing re-evaluation of *Erie,* with special emphasis upon its limitations. But the nature of diversity jurisdiction in a federal system of government is such that no definitive resolution is possible. The prognosis would indicate that the Supreme Court will soon be faced with a conflict between a federal statute and a state rule when the state rule reflects policy considerations which, under *Erie,* would lie within the realm of state legislative authority.

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Orenstein foresaw, as noted in *Erie Potpourri,* 38 CONN. B.J. 69 (1964). Orenstein proposed that federal rules be abolished in diversity cases!