Date of Hearing: April 30, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
AB 2260 (Hagman) – As Amended: March 29, 2012

SUBJECT: Foreign corporations.

SUMMARY: Makes various changes to California's foreign corporation law. Specifically, this bill:

1) Repeals provisions of California's foreign corporation law pertaining to conducting business in the state, meeting certain tests, and meeting specified provisions of the Corporations Code.

2) Specifies that the Corporations Code shall not be construed to authorize the state to regulate the organization or internal affairs of a foreign corporation qualified to do business in this state.

EXISTING LAW

1) Defines "foreign corporation" as any corporation other than a domestic corporation and does not include a corporation or association chartered under the laws of the United States. [Corporations Code, Section 171]

2) Requires foreign corporations qualified to conduct business in California to meet specified requirements including provisions relating to the election and removal of directors, shareholders" rights, vote requirements, and mergers. [Corporations Code, Section 2115]

3) Provides that directors of a foreign corporation transacting intrastate business are liable to the corporation, its shareholders, creditors, receiver, liquidator or trustee in bankruptcy for the making of unauthorized dividends, purchase of shares or distribution of assets or false certificates, reports or public notices or other violation of official duty according to any applicable laws of the state or place of incorporation or organization, whether committed or done in this state or elsewhere. Such liability may be enforced in the courts of this state. [Corporations Code, Section 2116]

FISCAL EFFECT: None.

COMMENTS:

According to the Author, "*Historically, corporations have not encountered conflicts between state laws. Controversies have been resolved by involving a corporation's internal affairs by applying the law of the state that created the corporation, irrespective of where that corporation is located or does business. This principle, known as the Internal Affairs Doctrine, is an established principle underlying the American free enterprise system, a state has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors have an effective voice in corporate affairs*.

AB 2260 takes the proactive step of repealing Section 2115 before the federal courts strike it down and the state is forced to spend additional taxpayer dollars defending and regulation that keeps companies out of California. All this section of code accomplishes is confusing well established national corporate governance law. Why would a company take the chance of subjecting itself to the extra regulation? We are seeing the results of this type of short sighted and arrogant legislation every time a company works to ensure that the "property" and "payroll" triggers are never met. Thus, a new plant will be built, and new jobs will be created but not in California."

The "internal affairs doctrine" of a corporation refers to the relationship between and among the corporation and its shareholders, creditors, officers and directors. Most corporations do not need to be incorporated under the laws of the state where they have their headquarters which brings attention to why this measure may be needed. Promoters forming a new corporation are free to select any state's laws to form their new corporation. State laws differ with respect to their requirement they impose on the internal affairs doctrine.

The efficient and profitable operation of a corporation demands certainty and predictability regarding the corporate law that applies to the company. In most states, there is no question about which law applies to corporations regarding their corporate governance. Indeed, it is a long-standing and fundamental principle of corporate law that a corporation's internal affairs are governed exclusively by the law of the state of incorporation. This is the Internal Affairs Doctrine. In California, however, Section 2115 attempts to supplant that law with California law. This situation can and does create great uncertainty for foreign corporations operating in California because the conflicting provisions come into play at critical times, such as when a corporation is trying to determine its shareholder vote for a merger. A corporation may find that its local state law requires it to take one course of action, while California state law requires it to take a different course of action.

California has created statutes that conflict with the Internal Affairs Doctrine for certain foreign corporations, i.e., corporations created under the laws of other states by enacting Section 2115 of the Corporations Code. For those foreign corporations to which it applies, Section 2115 can have significant impacts.

A foreign corporation becomes subject to Corporations Code, Section 2115 if: its shares are not traded on the New York Stock Exchange (NYSE) or NASDAQ; and it meets the requirements specified under current law which requires: over 50 percent of a corporation's property be located in California, over 50 percent of its payroll be paid in California, and over 50 percent of its sales occur in California.

These factors are calculated annually in every corporation's California tax return, and each can change from year-to-year. If these criteria are met, 50 percent of the corporation's voting shares must be held "of record" by Californians. The statute allows a corporation to: ignore the beneficial owners, request that nominee holders certify the number of shares held by persons with addresses inside and outside California; request that nominees provide the names and addresses of the beneficial owners who do not object to such disclosures

Corporations Code, Section 2115 imposes 22 sections of the Corporations Code on corporations organized in other states that have substantial business in California. Corporations Code, Section 2115 does not apply to publicly traded corporations. These provisions include such fundamental matters as shareholder voting requirements, the election and removal of directors, and mergers and acquisitions. Corporations Code, Section 2115 thus attempts to supplant the law of the state in which the foreign corporation is organized. AB 2260 would conform California law to the corporate law that prevails in most other jurisdictions: that the internal affairs of a corporation are governed by the law of the State in which the corporation is organized and which the organizers and shareholders have selected.

REGISTERED SUPPORT / OPPOSITION:

Support

The State Bar of California

Opposition

None on file.

Analysis Prepared by: Kathleen O'Malley / B. & F. / (916) 319-3081