Case No. S139285

IN THE
SUPREME COURT OF CALIFORNIA

RICHARD GROSSET,

Plaintiff,

vs.

ERIC P. WENAAS, ET AL.,

Defendants and Respondents,

SIK-LIN HUANG,

Intervener and Appellant

AFTER A DECISION BY THE COURT OF APPEAL,
FOURTH APPELLATE DISTRICT, DIVISION ONE
(4TH CIVIL NO. D043684), AFTER A DECISION BY THE
SAN DIEGO SUPERIOR COURT (NO. GIC 775153)

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS/RESPONDENTS

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INTEREST OF THE *AMICUS CURIAE*

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation, representing an underlying membership of more than three million corporations, companies, and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in the courts on issues of vital concern to the nation's business community.

Many of the Chamber's members that do business in California are incorporated in another State; and many of the Chamber's members that are incorporated in California engage in significant business in other States. The fundamental issue in this case regarding the application of the "internal affairs doctrine" is vital to all such corporations engaged in interstate commerce. Under that doctrine, the relationships among a corporation and its shareholders, directors, and officers are governed by one set of laws — the laws of the State in which that corporation is incorporated.

Adherence to the longstanding internal affairs doctrine provides corporations engaged in interstate commerce with needed certainty about which laws will govern their internal affairs, and avoids the risks associated with having a corporation's affairs subject to the potentially conflicting laws of each State in which they engage in business. Because the Chamber's members routinely rely on the internal affairs doctrine in the course of their business, they bring extensive practical experience to bear on the issues presented in this litigation.

Affirming the Court of Appeal's opinion would advance important policies underlying the internal affairs doctrine, relating to choice, certainty, and efficiency. Reversing the Court of Appeal's

decision, however, would undermine an important principle of corporate law on which the Chamber's members heavily rely. Accordingly, the interests of the Chamber and its members may be directly affected by the resolution of this case.

INTRODUCTION AND SUMMARY OF ARGUMENT

This is an appeal by a former shareholder of a corporation incorporated in Delaware brought against the corporation's directors and officers purportedly to seek relief on behalf of the corporation. It is undisputed that the corporation is incorporated in Delaware. It is further undisputed that, pursuant to Delaware's "continuous ownership" requirement, Intervener/Appellant ("Appellant") lacks standing under Delaware law to maintain derivative claims on behalf of the Delaware corporation because only current shareholders may do so under that State's law.

An individual's standing to initiate and maintain derivative litigation on behalf of a corporation is governed by the well-established internal affairs doctrine, which provides that the law of the State of incorporation governs. This is because a shareholder's right to sue on behalf of a corporation flows from the relationship between a corporation and its shareholders. Thus, a straightforward application of the internal affairs doctrine would require affirmance of dismissal of the appeal.

Appellant seeks to avoid this result by urging this Court not to apply Delaware law in deciding who may bring a derivative action on behalf of a Delaware corporation and, instead, to apply California law, which they urge is different than the rule applied by Delaware.

Because this case concerns the internal affairs of a Delaware corporation, this Court should assess Appellant's standing to pursue a derivative claim under Delaware law. Doing so will advance three

important policies that underly the internal affairs doctrine and that are vital to the Chamber's membership and thousands of other corporations worldwide.

First, applying Delaware law pursuant to the internal affairs doctrine will give full effect to the corporation's choice to incorporate in a particular State. This Court has held that it is the State of incorporation that has an "overriding interest" in regulating the internal affairs of corporations that have chosen the protections and assumed the obligations of its laws. (See *Nedlloyd Lines B.V. v. Super. Ct.* (1992) 3 Cal.4th 459, 471 [11 Cal.Rptr.2d 330, 834 P.2d 1148].) The internal affairs doctrine equally protects the interest of the States, including California, in regulating the affairs of their own corporations.

Second, the internal affairs doctrine provides legal certainty to corporations by assuring shareholders and management alike that a single State's laws will regulate the corporation's affairs. This certainty allows corporations and their management and shareholders to conform their conduct to a single body of known law. Moreover, this certainty reduces the burdens and legal costs associated with having to monitor and abide by multiple (and potentially conflicting) bodies of law all of which might otherwise govern a corporation's internal affairs.

Finally, the internal affairs doctrine promotes judicial efficiency. By specifying one set of laws that governs internal corporate affairs, the doctrine curtails threshold choice-of-law disputes that may divert parties and the courts from the merits of disputes involving corporate affairs. Additionally, the internal affairs doctrine reduces forum shopping and duplicative litigation because the doctrine puts all parties on notice that one State's laws will apply to internal corporate disputes, regardless of where the disputes are litigated.

For all of these reasons, the Court should hold that the internal affairs doctrine requires the application of Delaware law in this case and, on that basis, affirm the Court of Appeal's dismissal of the appeal because, as a matter of Delaware law, Appellant lacks standing to maintain this suit on behalf of a Delaware corporation whose stock Appellant no longer owns.

STATEMENT OF THE CASE

Appellant held stock in a Delaware corporation called JNI Corporation and intervened as a plaintiff in an already pending shareholder derivative action filed on behalf of JNI against the company's management. (See Respondents' Answer Brief ("Answer Br.") at p. 1.) The Superior Court later dismissed the derivative case, and, around the same time, JNI merged with another Delaware corporation called Applied Micro Circuits Corporation ("AMCC"). (See *id.* at p. 2.) As a result of the merger, Appellant no longer holds JNI stock. (See *id.*)

The original plaintiff did not appeal. The Court of Appeal dismissed Appellant's appeal "for lack of standing." (*Grosset v. Wenaas* (1995) 133 Cal.App.4th 710, 731 [35 Cal.Rptr.3d 58].) The Court of Appeal determined that "standing to pursue a derivative action is a substantive matter within the internal affairs doctrine and thus subject to Delaware law, the state of JNI's incorporation." (*Id.* at p. 724.) Under Delaware law, shareholders pursuing derivative actions are subject to a "continuous ownership requirement," which means that shareholders suing on behalf of a Delaware corporation must hold stock in that company throughout the litigation. (See *id.* at p. 721 [citing Del. Code Ann. tit. 8, § 327 (2006); *Lewis v. Anderson* (Del. 1984) 477 A.2d 1040, 1046].) Thus, the Court of Appeal held, Appellant cannot proceed with a derivative case on behalf of JNI

because Appellant no longer holds JNI stock as a result of that company's merger with AMCC.

The Court of Appeal held, in addition, that "[e]ven assuming California law applies . . . we conclude that [Appellant] has no standing to pursue this action because he no longer owns stock in JNI . . . ." (*Id.* at p. 726.) It noted, however, that this question of California law had divided the Courts of Appeal. (See *id.* at pp. 726-730 [discussing *Heckmann v. Ahmanson* (1985) 168 Cal.App.3d 119 [214 Cal.Rptr. 177] and *Gaillard v. Natomas Co.* (1985) 173 Cal.App.3d 410 [219 Cal.Rptr. 74]].)

This Court granted review to address both holdings. All the briefs that parties may file — other than supplemental briefs — were filed by August 17, 2006. (See Cal. Rules of Court, rule 29.1(f)(2).) On September 18, 2006, the Chamber timely applied for leave to submit this brief as an *amicus curiae* in support of Respondents.

ARGUMENT

This case touches on a question vital to the efficient operation of thousands of corporations nation- and world-wide: whether the relationships among a corporation and its directors, officers, and shareholders are governed by the law of the State of incorporation, or by the laws of each State in which the corporation does business?

This Court applies the internal affairs doctrine to determine which State (or sometimes foreign) law governs when a case concerns the relationships among corporations and their officers, directors, and shareholders. (See *Nedlloyd v. Super. Ct., supra,* 3 Cal.4th at p. 471 [finding that the state of incorporation's "overriding interest in the internal affairs of corporations domiciled there would in most cases require application of its law"]. See also *State Farm Mut. Auto. Ins. Co. v. Super. Ct.* (2003) 114 Cal.App.4th 434, 449 [8 Cal.Rptr.3d 56]

[applying Illinois law to internal affairs of Illinois corporation and citing *Nedlloyd* as among "a consistent line of authority [regarding] the internal affairs doctrine"].) Under the internal affairs doctrine, the law of the State of incorporation governs these relationships regardless of where a case may be pending. (See *ibid.*)

Appellant, a former shareholder of a corporation incorporated in Delaware, sought to appeal the dismissal of a derivative claim brought against the corporation's officers purportedly to seek relief on behalf of the corporation. The question of whether Appellant has standing to sue JNI's management on behalf of JNI itself concerns the relationships among JNI and its officers, directors, and shareholders. "A derivative claim belongs to the corporation, not to the shareholder who brings the action." (*In re MAXXAM, Inc./Federated Dev. Shareholders Litig.* (Del.Ch. 1996) 698 A.2d 949, 956; see also *Schuster v. Gardner* (2005) 127 Cal.App.4th 305, 312 [25 Cal.Rptr.3d 468] [stating that "[w]hen the claim is derivative, the shareholder is merely a nominal plaintiff . . . . Even though the corporation is joined as a nominal defendant . . . it is the real party in interest . . . ."] [quotations and citation omitted].) Furthermore, a derivative plaintiff's right to sue on behalf of a corporation flows from his or her status as a shareholder. (See *In re MAXXAM, supra,* 698 A.2d at p. 956 [stating that a derivative claim "exists solely because of the plaintiff's interest as a shareholder"].)

Respondents' Answer Brief explains why, under settled California law, this Court should affirm the Court of Appeal's holding that the internal affairs doctrine requires the application of Delaware law to determine who may bring and maintain a derivative action on behalf of a corporation that is incorporated in Delaware. This *amicus* brief provides a broader perspective on the important practical

considerations that underlie the internal affairs doctrine and have made it the touchstone for determining the choice of law regarding relationships among a corporation and its shareholder.

A. The Internal Affairs Doctrine Vindicates The Choices Of Corporations And Of The States

1. The doctrine gives effect to the considered choices of corporations in selecting a State of incorporation

A corporation's "very existence and attributes are a product of state law." (*CTS Corp. v. Dynamics Corp. of Am.* (1987) 481 U.S. 69, 89 [107 S.Ct. 1637, 95 L.Ed.2d 67].) Choosing the State in which to incorporate is among the first things that a corporation's organizers must do. (Kozyris, *Corporate Wars and Choice of Law*, (1985) Duke L.J. 1, 50 [stating that "the choice of the state of incorporation comes about by agreement among the organizers and its law is selected, explicitly or implicitly, to govern this private internal corporate relationship"].)

Moreover, the organizers' decision to incorporate in a particular State is made with the knowledge that "[c]orporate laws differ from state to state, in varying degrees." (Friedman, Cal. Practice Guide: Corporations (The Rutter Group 2005) § 3:1, p. 3-1.) Accordingly, organizers intentionally choose to incorporate in a specific State — often Delaware —so that the corporation is governed by a specific set of laws. (See, e.g., Ward & Kelly, *Why Delaware Leads in the United States as a Corporate Domicile*, (Fall 1991) 9 Del. Law., 15-16 [stating "[o]ther states have a paucity of court opinions interpreting their corporate statutes, and, often, the judicial interpretations that do exist do not afford the same level of certainty and predictability to practitioners using their corporate codes"].)

This Court based its decision in *Nedlloyd* on "California's policy of respecting the choices made by parties to voluntarily negotiated

agreements." (*Nedlloyd v. Super. Ct., supra,* 3 Cal.4th at p. 471.) The Court explained that deference to the parties' chosen law was consistent with "commercial reality" because parties who choose to be governed by one set of laws generally expect those laws to apply to all of their affairs. (See *id.* at p. 469.) Thus, in *Nedlloyd*, California's respect for individuals' choice of law required the Court to apply Hong Kong law to the internal affairs of a Hong Kong corporation. (See *id.* at p. 471.)

So too, here, California's policy of respect for individuals' choice of law should lead this Court to affirm the Court of Appeal's dismissal of this appeal. The founders of JNI elected to incorporate in Delaware. As a result, applying Delaware law to JNI's internal affairs is consistent with "the justified expectations of parties with interests in the corporation." (See *First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba* (1983) 462 U.S. 611, 621 [103 S.Ct. 2591, 77 L.Ed.2d 46].)

2. The doctrine also gives effect to each State's choices regarding substantive corporate law for its own corporations

Affirming the Court of Appeal on this basis also protects the choice of each State, including California, to establish its own substantive corporate law. In this case, the internal affairs doctrine requires the California courts to apply Delaware law to a dispute involving a Delaware corporation's internal affairs.[1] But if this case

[1] This case does not involve application of section 2115 of the Corporations Code, which purports to apply many provisions of California law to a "pseudo-foreign" corporation, *i.e.*, a corporation that does more than half of its business in California; and more than half of the corporation's voting securities are held by California residents. (See Corp. Code, § 2115, subds. (a), (b).) By its own terms, section 2115 does not apply to companies traded on national exchanges like JNI and AMCC. (See Corp. Code, § 2115, subd. (c).) Thus, there is no reason to address in this case whether a State

were pending in Delaware and involved a California corporation, the doctrine would require the Delaware courts to apply California law. Thus, by protecting the choice of the State of incorporation, the internal affairs doctrine also protects California's interest in regulating the internal affairs of California corporations — regardless of where disputes relating to those affairs might be litigated.

B. The Internal Affairs Doctrine Vests Corporations, Their Officers, And Their Shareholders With A Necessary Level Of Certainty Regarding Governing Law

"In corporation law, uncertainty about what the law is or what law is applicable to a given transaction constitutes a far more serious problem than in areas of the law which do not require comprehensive and continuous planning." (Halloran & Hammer, *Section 2115 of the New California General Corporation Law — The Application of California Corporation Law to Foreign Corporations*, (1976) 23 UCLA L.Rev. 1282, 1283.) As this Court stated in *Nedlloyd*, no "rational businessperson . . . would intend that the laws of multiple jurisdictions would apply to a single controversy . . . ." (See 3 Cal.4th at p. 470.) Thus, the internal affairs doctrine is vital to businesses because it eliminates uncertainty about the standards that govern their activities. (See, e.g., *Edgar v. MITE Corp.* (1982) 457 U.S. 624, 645 [102 S.Ct. 2629, 73 L.Ed.2d 269] [holding that "only one State should have the authority to regulate a corporation's internal affairs . . . because otherwise a corporation could be faced with conflicting demands"].)

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could regulate the internal affairs of corporations that are incorporated in other States even if it manifested a clear intent to do so. (See *VantagePoint Venture Partners 1996 v. Examen, Inc.* (Del. 2005) 871 A.2d 1108, 1115-1118 [finding that application of section 2115 to corporation that was incorporated under Delaware law would intrude on the internal affairs of the corporation in violation of the United States Constitution].)

The risk that, in the absence of the internal affairs doctrine, conflicting standards could apply to a single transaction or dispute is not hypothetical. Substantive differences in various States' laws governing a corporation's internal affairs are common. There is "substantial non-uniformity among the states" in corporate law and each State continues to revise its laws "at its own pace and with reference to different sources." (Clark, *Rationalizing Entity Laws,* (May 2003) 58 Bus. Law. 1005, 1016; see Kozyris, *Corporate Wars and Choice of Law*, (1985) Duke L.J. 1, 10 [noting the trend away from state uniformity in corporate law and stating that differences in state law "may well be outcome-determinative."].)

For example, in 1997, a federal court in Nevada had suggested that Nevada law imposes duties on corporate directors of Nevada corporations equivalent to those imposed on directors of Delaware corporations by Delaware Supreme Court decisions, including *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* (Del. 1986) 506 A.2d 173. (See *Hilton Hotels Corp. v. ITT Corp.* (D.Nev. 1997) 978 F.Supp. 1342, 1346-1347.) One of *Revlon*'s holdings is that directors of a Delaware corporation in a transaction involving a change of control must seek the best price for the corporation's shareholders; the directors are not to consider non-shareholder constituencies unless doing so is beneficial to the shareholders. (See *Revlon v. MacAndrews, supra,* 506 A.2d at pp. 182-185.) In 1999, however, the Nevada Legislature amended Nevada law to include language contrary to this holding from *Revlon.* Nevada law now provides that directors "are not required to consider the effect of a proposed corporate action upon any particular group having an interest in the corporation as a dominant factor." (See 1999 Nev. Stats., ch. 357, § 67 (codified at Nev. Rev. Stats. Ann. 78.138(5) (2006)).) Accordingly, the directors of Delaware

and Nevada corporations have different duties in connection with transactions involving a change of corporate control.[2]

Indeed, the resolution of this appeal could turn on the Court's decision whether to apply the internal affairs doctrine. If it does apply, the parties are in agreement that Appellant lacks standing to proceed with a derivative case on behalf of JNI because Delaware law requires continuous ownership in order to maintain such a suit. (See Opening Br. at pp. 30-33.) On the other hand, if the internal affairs doctrine does not apply, and California law is selected under a generalized choice-of-law analysis, Appellant contends that he has standing to proceed. (See *id.* at pp. 13-18 [discussing Appellant's view that California law does not include a continuous ownership requirement].)[3]

By eliminating doubt about the controlling State law in situations where conflicting State laws otherwise could apply, the

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[2] Other differences among States' corporate laws abound. For instance, the Delaware Supreme Court has held that California and Delaware law conflicts with respect to the type of shareholder vote necessary to approve certain mergers. (See *VantagePoint v. Examen, Inc.*, *supra*, 871 A.2d at p. 1111 [discussing differing voting requirements].) California and Delaware law also conflicts with respect to the scope of indemnification available to directors. (See Marsh, Finkle & Sonsini, Marsh's California Corp. Law (4th Ed. 2006) § 2.05[D], at 2-44 [stating that "[w]hile the indemnification provisions of the California General Corporation Law were adapted from those of the Delaware General Corporation Law, there are several significant differences between the two statutes"].) Meanwhile, Delaware and Nevada law conflicts with respect to exculpating directors for breaches of their duties. (See McBride & Nelson, Organizing Corporations in California (Cont.Ed.Bar.Supp. 2006) § 1.133, p. 92 [stating that Delaware permits exculpation while Nevada changed its laws to prohibit exculpation].)

[3] For the reasons discussed in Respondents' brief, the Chamber agrees with the Court of Appeal's holding that California law includes a continuous ownership requirement. (See Answer Br. at pp. 14-34.) Of greater importance to the Chamber and its members, however, is that this Court remain among the majority of courts that apply the internal affairs doctrine. Accordingly, the Chamber believes that this case should be decided under Delaware law, and this brief addresses only the first issue presented for review.

internal affairs doctrine simultaneously promotes compliance and reduces the legal costs associated with compliance. Knowing what rules to apply makes it much easier for corporations and their directors, officers, and shareholders to conform their conduct to those rules. This, in turn, reduces legal expenses by eliminating the need for corporations to monitor multiple bodies of law. Because certainty and its offspring — increased compliance and reduced legal cost — are all goals of California law, this Court should affirm the Court of Appeal's decision by reaffirming the internal affairs doctrine. (See *Nedlloyd v. Super. Ct., supra,* 3 Cal. 4th at pp. 469-470.)

C. The Internal Affairs Doctrine Promotes Efficient Resolution Of Corporate Disputes

As this Court stated in *Nedlloyd*, no "person would reasonably desire a protracted litigation battle concerning only the threshold question of what law was to be applied to which asserted claims or issues." (See *id.* at p. 470.) This case, however, is just such a battle, and Appellant seeks a ruling that would increase incentives for forum-shopping, as well as threshold litigation, in all cases involving corporate law filed in California. These outcomes would be contrary to established principles of California law. (See *id.* at p. 470 [dismissing, as contrary to California law, argument that "would require extensive litigation of the parties' supposed intentions regarding the choice-of-law clause to the end that the laws of multiple states might be applied to their dispute"].)

"California courts do not throw their doors wide open to forum shopping." (*Appalachian Ins. Co. v. Super. Ct.* (1984) 162 Cal.App.3d 427, 438 [208 Cal.Rptr. 627] [issuing writ of mandate directing dismissal of California action]; see also *Stangvik v. Shiley Inc.* (1991) 54 Cal.3d 744, 754 [1 Cal.Rptr.2d 556, 819 P.2d 14] [stating that "the fact that California law would likely provide plaintiffs with certain

advantages of procedural or substantive law cannot be considered as a factor in plaintiffs' favor" when considering the issue of where a claim should be litigated].) The internal affairs doctrine likewise discourages forum-shopping by ensuring that one State's laws will apply to a dispute about a corporation's internal affairs — regardless of the forum in which the dispute is litigated. Appellant's desired outcome is contrary to these policies and would encourage a plaintiff to litigate a corporate dispute in multiple fora, hoping to find one forum that applies law more favorable to his or her position than the law of the State of incorporation of the corporation on whose behalf he is purportedly suing.[4]

Forum-shopping also increases threshold litigation concerning choice of law and this, too, is contrary to established California policy. Like all States, California favors resolving disputes on the merits. (See *Shamblin v. Brittain* (1988) 44 Cal.3d 474, 478 [243 Cal.Rptr. 902, 749 P.2d 339] [stating "[i]t is the policy of the law to favor, whenever possible, a hearing on the merits"].) As this Court suggested in *Nedlloyd*, threshold litigation about choice of law is an expensive distraction from the merits of a dispute. (See 3 Cal.4th at pp. 469-470 [discussing how choice of law disputes contrary to "the interest of economy in dispute resolution"].) For this reason, too, the Court should reaffirm the applicability of the internal affairs doctrine because it promotes the efficient resolution of corporate disputes.

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[4] For these reasons, Appellant's desired outcome is also inconsistent with California's related policy against duplicative litigation. (See *Century Indem. Co. v. Bank of America, FSB* (1997) 58 Cal.App.4th 408, 412 [68 Cal.Rptr.2d 132] [stating that "trial court should consider the importance of discouraging multiple litigation designed solely to harass an adverse party, and of avoiding unseemly conflicts with the courts of other jurisdictions" (quotations and citations omitted)].)

CONCLUSION

For the foregoing reasons and the reasons stated in Respondents' Answer Brief, the Court should affirm the judgment of the Court of Appeal.

Dated: September 18, 2006

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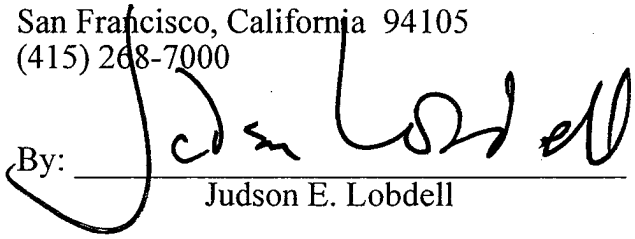
By: 
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CERTIFICATE OF WORD COUNT
(Cal. Rules of Court, Rule 14(c)(1))

I hereby certify that this brief conforms to the 14,000-word limit imposed by California Appellate Rules of Court 14(c)(1) and that this brief contains 3,578 words, as shown by the word-count function of the computer program used to prepare this brief.

Dated: September 18, 2006 Chamber of Commerce of the United States of America

By: _____
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DECLARATION OF SERVICE

I, Ruby M. Lim, declare as follows:

I am employed with the Morrison & Foerster LLP, whose address is 425 Market Street, San Francisco, CA 94105. I am readily familiar with the business practices of this office for collection and processing of correspondence. I am over the age of eighteen years and not a party to this action.

On September 18, 2006 I served the Chamber of Commerce of the United States Of America's

> BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS/RESPONDENTS

on the parties listed on the attached Service List in this action by placing true copies thereof in sealed envelopes, addressed as shown, for collection and delivery by overnight mail to the parties indicated.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on September 18, 2006 in San Francisco, California.

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