

Adjudicative Jurisdiction and the Market for Corporate Charters

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Both in the United States and in Europe, corporations are free to choose the applicable corporate law by incorporating in the jurisdiction of their choice. However, smaller firms face a number of obstacles in exercising that choice. One such obstacle concerns the law on adjudicative jurisdiction: In the United States as well as in the European Community, corporations are exposed to third-party suits in their state of incorporation even if they have no other ties to that state.

In this Article, I argue that while the relevant rule may not matter much in the United States, it probably imposes a considerable burden on corporations in Europe. Moreover, I show that there is no convincing justification for the relevant Community law rule. It does not promise to increase the combined gains reaped by contracting parties, nor can it be expected to achieve either a substantive increase in positive externalities or a significant reduction in negative externalities. Finally, it cannot even be justified persuasively on fairness grounds.

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I. INTRODUCTION

U.S. corporations have long been free to choose the state law governing their internal affairs.¹ More recently, the European Court of Justice has accorded the same right to corporations in the European Community.² This freedom of choice has its critics. They suggest that

1. See, e.g., ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION 63 (2002); Alan E. Garfield, Comment, *Evaluating State Anti-Takeover Legislation: A Broadminded New Approach to Corporation Law or "A Race to the Bottom"?*, 1990 COLUM. BUS. L. REV. 119, 122.

2. The leading cases are Case C-212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1459; Case C-208/00, *Überseering BV v. Nordic Constr. Co. Baummanagement GmbH (NCC)*, 2002 E.C.R. I-9919; and Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, 2003 E.C.R. I-10,155. For an analysis of the role these cases play in allowing corporations to choose the applicable corporate law, see, for example, Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 484-86 (2004); Friedrich Kübler, *A Shifting Paradigm of European Company Law?*, 11 COLUM. J. EUR. L. 219, 226-29 (2005); Christian Joerges, *The Challenges of Europeanization in the Realm of Private Law: A Plea for a New Legal Discipline*, 14 DUKE J. COMP. & INT'L L. 149, 173-83 (2004); Peer Zumbansen, *Spaces and Places: A Systems Theory Approach to Regulatory Competition in European Company Law*, 12 EUR. L.J. 534, 543-46 (2006). A different question is whether the member states have sufficient incentives to compete for corporate charters. I have argued that they do. See Dammann, *supra*, at 520-30. Others have taken the view that the member states will not compete. See, e.g., Hanne Søndergaard Birkmose, *A Market for Company Incorporations in the European Union?—Is Überseering the Beginning of the End?*, 13 TUL. J. INT'L & COMP. L. 55, 106 (2005) (believing it to be "questionable whether the Member States will have sufficient incentives to compete for company incorporations"); Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U. PA. J. INT'L ECON. L. 1, 6-8 (2006) (asserting that the member states of the European Community "are not now engaged in a competition for corporate charters, and cannot be expected to engage in one in the near future"); Ehud Kamar, *Beyond Competition for Incorporations*, 94 GEO. L.J. 1725, 1728 (2006) ("There is no reason to believe that European countries will be any more interested in

states will compete for corporate charters by offering law that benefits managers at the expense of shareholders.³ However, the prevailing view in both Europe and the United States is more optimistic.⁴ It holds that managers, driven by the pressure of capital markets, will tend to choose rules that maximize shareholder wealth.⁵ While the adherents of this view acknowledge that state competition does not produce perfect results, they assert that, on balance, it benefits shareholders.⁶ In this Article, I do not intend to reopen this debate. Rather, I simply assume the benign account of state competition to be correct.

Once one assumes that the freedom to choose the applicable corporate law is desirable, the question arises as to whether the legal framework should be modified to make it easier for corporations to make use of the freedom to choose. In particular, there is the question of whether the rules governing adjudicative jurisdiction ought to be adjusted. Both in the United States and in the European Community, third parties can sue a corporation in its state of incorporation,

incorporations than most American states, which make little effort to compete with Delaware.”); Tobias H. Tröger, *Choice of Jurisdiction in European Corporate Law—Perspectives of European Corporate Governance*, 6 EUR. BUS. ORG. L. REV. 3, 14-30 (2005) (questioning whether the member states have sufficient incentives to compete).

3. See, e.g., Lucian A. Bebchuk, *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784, 1812 (2006) (“Overall, there is a strong basis for concluding that state law has been and continues to be distorted in management’s favor.”); Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775, 1821 (2002) (“[T]he view supportive of state competition in corporate law (as currently structured) does not have the empirical basis believed to exist by supporters”); Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race To Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1199 (1999) (“There are strong theoretical reasons to expect that state competition will work to produce a body of corporate law that excessively protects incumbent managers. . . . The development of state takeover law . . . is consistent with this view.”).

4. See ROMANO, *supra* note 1, at 65 (arguing that capital markets will keep a corporation’s managers from selecting a jurisdiction that favors their interests); Dammann, *supra* note 2, at 508-11 (predicting that European corporations will migrate toward laws that are the most efficient).

5. See sources cited *supra* note 4.

6. See, e.g., ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 16 (1993) (asserting that, in the United States, state competition “benefits rather than harms shareholders”); Horst Eidenmüller, *Free Choice in International Corporate Law: European and German Corporate Law in European Competition Between Corporate Law Systems*, in *AN ECONOMIC ANALYSIS OF PRIVATE INTERNATIONAL LAW* 187, 205 (Jürgen Basedow et al. eds., 2006) (“The fear that [state competition in European corporate law] will lead to a race to the bottom is unjustified.”); Dammann, *supra* note 2, at 542 (concluding that “free choice is both a viable and desirable policy choice for the European Community”); Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 847 (1993) (“While state competition is an imperfect public policy instrument, on balance it benefits investors.”).

regardless of where the corporation's headquarters is located.⁷ While this is unlikely to matter to large, publicly traded corporations, it has been suggested that fear of exposure to litigation may help to explain why smaller firms tend to incorporate locally.⁸

In a related article, I suggested modifying European Community (Community) law so as to ensure that the mere act of incorporating in a given state does not expose corporations to litigation in that state.⁹ In this Article, I provide a more in-depth analysis of this problem. I show that while the rule at issue may well have little practical importance in the United States, it likely imposes a considerable burden on corporations in the European Community. Moreover, there is no convincing justification for this burden.

For the sake of clarity, I should note that I am only concerned here with litigation pertaining to the corporation's external affairs—its relationships with third parties such as customers, suppliers, etc. By contrast, I do not address the question of which state should have jurisdiction over litigation pertaining to the corporation's internal affairs, an issue that I have addressed elsewhere.¹⁰

Part II summarizes the existing legal framework in the United States and in Europe. Part III explains why exposing corporations to litigation in the state of incorporation is likely to be much more burdensome for European corporations than for their U.S. counterparts. Part IV argues that there is no convincing justification for the relevant Community law rule. Possible reforms are discussed in Part V.

7. See *infra* Part II. Under the law of the European Community, corporations are also forced to litigate certain internal affairs in the courts of the state of incorporation. Dammann, *supra* note 2, at 497-507. However, that is a different problem that I will not address in this Article.

8. See Ian Ayres, *Judging Close Corporations in the Age of Statutes*, 70 WASH. U. L.Q. 365, 374-75 (1992) (pointing out that exposure to litigation in the state of incorporation may be one of the factors accounting for the tendency of closely held firms in the United States to incorporate locally). In regard to the European Community, exposure to litigation in the state of incorporation is one of the obstacles to corporate mobility in the European Community. See Dammann, *supra* note 2, at 492-97; Eidenmüller, *supra* note 6, at 191 n.18 (“Being possibly sued in the incorporation jurisdiction will probably be a significant barrier to mobility, particularly for small and medium-sized pseudo-foreign companies.”).

9. See Dammann, *supra* note 2, at 497, 544.

10. *Id.* at 493-96 (arguing that article 22(2) of the Council Regulation, a provision that grants the state of incorporation exclusive jurisdiction over certain matters that are internal to the corporation, imposes an undue burden on corporate mobility and should be eliminated); see Christian Kirchner, Richard W. Painter & Wulf A. Kaal, *Regulatory Competition in EU Corporate Law After Inspire Art: Unbundling Delaware's Product for Europe*, 2 EUR. CORP. & FIN. L. REV. 159, 164-65 (2005) (arguing that at least some member states might compete more successfully for corporations if they “unbundled” the substantive law and the judicial services they offer).

II. THE EXISTING LEGAL FRAMEWORK

Both in the United States and in Europe, corporations are exposed to litigation in their state of incorporation, even if their principal place of business is in another state.¹¹

A. *The European Community*

In the European Community, this result follows from a combination of Community law and member state law. A central role is played by Council Regulation (EC) No. 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (Council Regulation).¹²

Under the Council Regulation, defendants can be sued in the jurisdiction in which they are domiciled.¹³ In addition to this so-called general forum, the Council Regulation also provides for a number of special forums, i.e., forums where particular causes of action can be pursued. For example, tort victims can sue the defendant corporation in the state in which the harmful event occurred.¹⁴ However, these special forums typically do not replace the general forum.¹⁵ In other words, even if a special forum is available in some other member state, a defendant can still be sued in the state in which she is domiciled.

The Council Regulation further provides that corporations are domiciled in the place where their statutory seat, their central administration, or their principal place of business is located.¹⁶ This rule is generally understood to mean that corporations can be sued in any state that is home to their statutory seat, central administration, or principal place of business, even if all three are in different states.¹⁷ It

11. Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNAT'L L. 51, 60 (2005).

12. Council Regulation 44/2001, 1 (EC) 2001 O.J. (L 12) [hereinafter Council Regulation].

13. *Id.* art. 2(1) ("Subject to this Regulation, persons domiciled in a [jurisdiction] shall, whatever their nationality, be sued in the courts of that [jurisdiction].").

14. *Id.* art. 5(3).

15. There are exceptions to this rule. Article 22 of the Council Regulation lists a number of cases in which the courts of a specific member state have exclusive jurisdiction regardless of where the defendant is domiciled. *Id.* art. 22. For example, "in proceedings which have as their object rights *in rem* in immovable property or tenancies of immovable property, the courts of the Member State in which the property is situated" have exclusive jurisdiction. *Id.* art. 22(1).

16. *Id.* art. 60(1)(a)-(c).

17. E.g., Eric Jayme & Christian Kohler, *Europäisches Kollisionsrecht 1999—Die Abendstunde der Staatsverträge*, 19 PRAXIS DES INTERNATIONALEN PRIVAT-UND VERFAHRENSRECHTS [IPRAX] 401, 406 (1999) (pointing out that each of the relevant places now confers jurisdiction).

follows that corporations can be sued in the state where their statutory seat is located, even if they conduct all of their business activities elsewhere. Needless to say, this would not matter if corporations were free to choose where to locate their statutory seat. However, that is not the case. Rather, member state law typically requires domestic corporations to choose a statutory seat that is located in their state of incorporation.¹⁸

B. *The United States*

Within the United States, corporations are also exposed to litigation in their state of incorporation. As a general matter, it is noteworthy that U.S. states enjoy more autonomy in defining the jurisdiction of their courts than do the member states of the European Community. Within the limits imposed by the United States Constitution¹⁹—and in particular by the Due Process Clause²⁰—it is, in principle, up to the states to define the jurisdiction of their courts.²¹ Concerning their own domestic corporations, states have defined the

18. In Germany, the German Stock Corporation Act does not explicitly address this issue, but it is nonetheless recognized that the statutory seat needs to be located in Germany. *See, e.g.*, UWE HÜFFER, AKTIENGESETZ 31-32 (7th ed. 2006). In France, the certificate of incorporation has to specify the corporate seat (*siège social*). CODE DE COMMERCE [C. COM.] art. L-210-2 (Fr.). In order for French corporate law to apply, the corporate seat has to be in French territory. *Id.* art. L-210-3.

For the sake of clarity, it should be noted that both German and French law still prevent domestic corporations from choosing a statutory seat that differs from their real seat. Thus, the German Stock Corporation Act explicitly provides that, as a rule, the certificate of incorporation has to specify as the corporation's statutory seat the place where the corporation's central administration or principal place of business is located. Aktiengesetz [AktG] [Stork Corporation Act], Sept. 6, 1965, BGBl. I at 37, § 5(2) (F.R.G.), *translated in* GERMAN STOCK CORPORATION ACT 35-36 (Friedrich K. Juenger & Lajos Schmidt trans., 1967). Under French law, if the statutory seat diverges from the corporation's real seat, third parties can invoke the statutory seat, but the corporation cannot. C. COM. art. L-210-3.

In regard to the United Kingdom, the Council Regulation explicitly provides that “[f]or the purposes of the United Kingdom and Ireland ‘statutory seat’ means the registered office.” Council Regulation, *supra* note 12, art. 60(2). Under the U.K. Companies Act 2006, the registered office has to be located in “England and Wales (or in Wales), in Scotland or in Northern Ireland.” Companies Act, 2006, c. 46, § 9 (Eng.).

19. There are other limitations besides those resulting from the Due Process Clause, though they are of no concern to the issue at hand. *See Missouri v. Lewis*, 101 U.S. 22, 30 (1880) (“It is the right of every State to establish . . . courts . . . and to prescribe their several jurisdictions as to territorial extent . . . provided it does not encroach upon the proper jurisdiction of the United States, and does not abridge the privileges and immunities of citizens of the United States, and does not deprive any person of his rights without due process of law, nor deny to any person the equal protection of the laws, including the equal right to resort to the appropriate courts for redress.”).

20. *See Kulko v. Superior Court*, 436 U.S. 84, 91 (1978) (requiring “a sufficient connection between the defendant and the forum State [for personal jurisdiction]”).

21. *See Lewis*, 101 U.S. at 30.

personal jurisdiction of their own courts generously: all U.S. states currently allow their courts to assert general jurisdiction over the states' domestic corporations.²² Moreover, there is widespread agreement that this does not violate the Due Process Clause.²³

For the sake of clarity, it should be added that by incorporating outside the state where its primary place of business is located, a corporation exposes itself to litigation not only in state courts of the state of incorporation but also in federal courts sitting within the state of incorporation.²⁴ This is because the personal jurisdiction of federal district courts follows that of the state courts where the district court is located.²⁵

III. THE BURDEN IMPOSED ON CORPORATIONS

As explained above, both European and U.S. corporations are exposed to litigation in the state of incorporation. However, while this rule may not matter much to U.S. corporations, the resulting burden is likely much greater for their European counterparts.

A. *Other Bases for Jurisdiction*

To begin with, the rule that a corporation can be sued in its state of incorporation only has practical relevance if the corporation could not otherwise be sued in the relevant state. This point is crucial because U.S. states claim far more extensive jurisdiction over

22. See, e.g., ALASKA STAT. § 9.05.015(a)(1)(c) (2006); DEL. CODE ANN. tit. 10, § 3111 (1999); WIS. STAT. ANN. § 801.05(8) (West 1994).

23. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 41 (1971) (“A state has power to exercise judicial jurisdiction over a domestic corporation.”); Diane S. Kaplan, *Paddling Up the Wrong Stream: Why the Stream of Commerce Theory Is Not Part of the Minimum Contacts Doctrine*, 55 BAYLOR L. REV. 503, 598-99 (2003) (“Jurisdiction . . . can be validly exercised when a defendant . . . is . . . incorporated in a forum.”); Roger H. Trangsrud, *The Federal Common Law of Personal Jurisdiction*, 57 GEO. WASH. L. REV. 849, 895 (1989) (“[C]orporations should be and are amenable to suit in their state of incorporation, because by electing to be incorporated under the laws of a particular state a corporation has freely chosen to affiliate itself with that state.”). Admittedly, it has been questioned whether the state of incorporation is always entitled to assert adjudicative jurisdiction over domestic corporations. EUGENE F. SCOLES & PETER HAY, CONFLICT OF LAWS § 9.2, at 325 (2d ed. 1992) (stating that while “[a] corporation which is organized and incorporated under the laws of a state has always been assumed to be subject to the jurisdiction of the courts of that state . . . there are some circumstances in which this historically sound rule may not be applicable”). However, I am not aware of any case in which the Due Process Clause was held to preclude a state from exercising jurisdiction over a domestic corporation.

24. See FED. R. CIV. P. 4(k)(1)(A).

25. *Id.* (“Serving a summons . . . establishes personal jurisdiction over a defendant . . . who is subject to the jurisdiction of a court of general jurisdiction in the state where the district court is located. . .”).

nonresident defendants than the member states of the European Community do.

As discussed above, U.S. states are, in principle, free to define the jurisdiction of their courts within the limits imposed by the U.S. Constitution.²⁶ Perhaps not surprisingly, states have made ample use of this freedom by enacting so-called long-arm statutes.²⁷ Some of these statutes explicitly allow courts to exercise personal jurisdiction to the full extent permitted by the U.S. Constitution.²⁸ Other statutes reach a similar result by listing numerous bases for personal jurisdiction over out-of-state defendants.²⁹ In states that have enacted statutes of the latter type, personal jurisdiction is typically ascertained in two steps: first, the courts interpret the long-arm statute to determine whether it grants a basis for asserting personal jurisdiction; then, they ask whether the exercise of jurisdiction is still within the limits set by the U.S. Constitution.³⁰ Regardless of which one of the two aforementioned approaches states take, the practical result tends to be the same—namely that jurisdiction is asserted to the constitutionally permissible extent.

The situation is quite different in the European Community. There, the previously mentioned Council Regulation contains detailed rules regarding the allocation of jurisdiction in civil and commercial matters.³¹ As a result, the scope of the member states' jurisdiction is much narrower than that of their U.S. counterparts.³²

26. See *supra* notes 19-21 and accompanying text.

27. See, e.g., Douglas D. McFarland, *Dictum Run Wild: How Long-Arm Statutes Extended to the Limits of Due Process*, 84 B.U. L. REV. 491, 525-31 (2004) (providing a brief overview of existing long-arm statutes).

28. See, e.g., CAL. CIV. PROC. CODE § 410.10 (West 2004) (“A court of this state may exercise jurisdiction on any basis not inconsistent with the Constitution of this state or of the United States.”).

29. E.g., CONN. GEN. STAT. ANN. § 52-59b (West 2005); DEL. CODE ANN. tit. 10, § 3104 (1999); GA. CODE ANN. § 9-10-91 (2007); WIS. STAT. ANN. § 801.05 (West 1994).

30. E.g., *Hercules Inc. v. Leu Trust & Banking Ltd.*, 611 A.2d 476, 480 (Del. 1992); *In re Liquidation of All-Star Ins. Corp.*, 327 N.W.2d 648, 650 (Wis. 1983).

31. Council Regulation, *supra* note 12, arts. 2-26.

32. This has been noted with respect to the precursor of the Council Regulation, namely the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, 1990 O.J. (C 189) 1, which, in content, was largely identical to the Council Regulation that has replaced it. See, e.g., Peter F. Schlosser, *Lectures on Civil-Law Litigation Systems and American Cooperation with Those Systems*, 45 U. KAN. L. REV. 9, 31 (1996) (“The philosophy of the Convention is that only in rather narrow, exceptional circumstances could someone be sued in a state other than the state of his residence.”); Linda Silberman, *Comparative Jurisdiction in the International Context: Will the Proposed Hague Judgments Convention Be Stalled?*, 52 DEPAUL L. REV. 319, 328 (2002) (noting that the Brussels Convention “is premised on the existence of a limited number of possible fora from which a plaintiff may choose”).

A simple example may serve to illustrate this point. A sales contract is concluded between a seller who is domiciled in Germany and a buyer who is domiciled in France. According to the contract, the goods are to be delivered “f.o.b. Berlin, Germany.” Upon receipt of the goods, the buyer finds that they are defective and decides to sue the seller. Can the buyer bring suit in France, the jurisdiction where he is domiciled?

Under the Council Regulation, the buyer can bring suit in the member state where the defendant is domiciled.³³ In the above example, however, this would be Germany. Further, with respect to the sale of goods, the Council Regulation makes it clear that either party can sue in the state “where, under the contract, the goods were delivered or should have been delivered.”³⁴ Because of the words “under the contract,” the relevant passage is generally understood to mean that the place of delivery can be specified by contractual provisions such as f.o.b. clauses.³⁵ In the case at hand, the f.o.b. clause turns Berlin into the place of delivery. Given that no other forums are available under the Council Regulation, the buyer has no choice but to bring suit in Germany, the state where the defendant is domiciled. That is true even if the seller has had frequent and systematic contacts with France.

In the United States, by contrast, the outcome of an analogous case would have depended on the facts of the case and, in particular, on the extent of the seller’s contacts with the state where the buyer resides.³⁶ For example, assume that the seller resides in New York and the buyer resides in Wisconsin. Under Wisconsin law, personal jurisdiction over nonresident defendants exists when the requirements of Wisconsin’s long-arm statute are met and the exercise of jurisdiction comports with the Due Process Clause.³⁷ Depending on the facts of the case, Wisconsin may be able to assert general jurisdiction over the defendant. Under the relevant Wisconsin statute, service of process suffices to establish personal jurisdiction in cases in which the defendant is “engaged in substantial and not isolated activities” in Wisconsin.³⁸ Moreover, the exercise of general jurisdiction does not

33. Council Regulation, *supra* note 12, art. 4(1).

34. *Id.* art. 5(1)(b).

35. *E.g.* Peter Mankowski, *Art. 5*, in BRUSSELS I REGULATION 77, 138 (Ulrich Magnus & Peter Mankowski eds., 2007).

36. *See infra* note 42 and accompanying text.

37. *In re Liquidation of All-Star Ins. Corp.*, 327 N.W.2d 648, 650 (Wis. 1983).

38. WIS. STAT. ANN. § 801.05(1)(e) (West 2004).

exceed the limits set by the Due Process Clause where the defendant maintains “continuous and systematic” contacts with the forum state.³⁹

Even in the absence of continuous and systematic contacts, Wisconsin courts may still be able to exercise specific jurisdiction, i.e., jurisdiction over causes of action that relate to the purchase in Wisconsin. Under the Wisconsin statute, service of process suffices to establish personal jurisdiction in any case relating to “goods . . . actually received by the plaintiff in [Wisconsin] from the defendant without regard to where delivery to carrier occurred.”⁴⁰ To be sure, specific jurisdiction, too, can be exercised only within the limits of the Due Process Clause. And the mere conclusion of a contract is generally thought to be insufficient to satisfy the minimum contacts requirement even for purposes of specific jurisdiction.⁴¹ However, in practice, the seller often has other contacts with the forum that relate to the relevant transaction, and these other contacts are frequently deemed sufficient for the purpose of exercising specific jurisdiction.⁴²

39. See *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 416 (1984).

40. WIS. STAT. ANN. § 801.05(5)(d).

41. See, e.g., *Scullin Steel Co. v. National Ry. Utilization Corp.*, 676 F.2d 309, 312-14 (8th Cir. 1982) (holding that the mere conclusion of a contract is insufficient to establish minimum contacts with the forum state); *Lakeside Bridge & Steel Co. v. Mountain State Constr. Co.*, 597 F.2d 596, 603 (7th Cir. 1979) (holding that the placement of an order is insufficient to create sufficient contacts to satisfy the Due Process Clause); *O.N. Jonas Co. v. B & P Sales Corp.*, 206 S.E.2d 437, 439 (Ga. 1974) (ruling that the conclusion of a contract is insufficient to create jurisdiction over a buyer).

42. This is best illustrated by the Supreme Court’s decision in *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). There, the State of Washington brought suit against an out-of-state seller to collect sales tax. *Id.* at 311-12. The goods had been shipped “f.o.b. from points outside Washington to the purchasers within the state.” *Id.* at 314. Moreover, the seller had “no office in Washington and ma[de] no contracts either for sale or purchase of merchandise there.” *Id.* at 313. However, the seller “employed eleven to thirteen salesmen” who “resided in Washington” and whose “principal activities were confined to that state.” *Id.* These salesmen were paid on a commission basis, their total commission each year totaling more than \$31,000, and they received samples from the seller that they “display[ed] to prospective purchasers.” *Id.* at 313-14. The salesmen also occasionally rented “permanent sample rooms,” and the cost incurred for these rooms was reimbursed by the seller. *Id.* at 314. Based on these facts, the Supreme Court had no trouble finding that the courts of the State of Washington had specific jurisdiction. *Id.* at 321.

Another case involved a Japanese seller and an American buyer. *Mid-Am. Tablewares, Inc. v. Mogi Trading Co.*, 100 F.3d 1353, 1357-58 (7th Cir. 1996). There, the seller had its principal place of business in Japan. *Id.* at 1357. The goods were shipped “F.O.B. Nagoya, Japan,” and the buyer “was responsible for all freight, duties, and insurance from that point forward.” *Id.* at 1357-58. Nonetheless, the court found that the seller could be sued in Wisconsin where the goods were received. *Id.* at 1362. Inter alia, the court based its conclusion on the facts that the seller had sent a number of faxes to Wisconsin, that the seller had sent various sample products to Wisconsin, that the seller’s senior merchandise manager had met the buyer in Wisconsin, that the seller knew the goods were destined for a warehouse in Wisconsin, and that the seller once had sent various replacement parts directly to

In sum, those parties most likely to want to sue U.S. corporations in their state of incorporation—namely suppliers and customers who reside in that state—are much more likely than their European counterparts to be able to do so even in the absence of a rule exposing corporations to litigation in their state of incorporation.

B. *The Forum Non Conveniens Doctrine*

Another crucial difference between the United States and the European Community relates to the so-called forum non conveniens doctrine.

1. The United States

Under the forum non conveniens doctrine, which most U.S. states recognize in one form or another,⁴³ a court may decline to exercise jurisdiction if it considers itself an unsuitable forum.⁴⁴ In making this decision, the court will balance various factors including access to evidence, the desirability of trial by jury in the locality of the relevant events, the domiciles of the parties, and the difficulty of applying unfamiliar law.⁴⁵

Wisconsin. *Id.* at 1360-61. For a more detailed overview of the relevant case law see, for example, Pamela J. Stephens, *The Single Contract as Minimum Contacts: Justice Brennan "Has It His Way,"* 28 WM. & MARY L. REV. 89, 91-100 (1986).

43. See Robert C. Casad, *Jurisdiction in Civil Actions at the End of the Twentieth Century: Forum Conveniens and Forum Non Conveniens*, 7 TUL. J. INT'L & COMP. L. 91, 104-10 (1999); see also *Stangvik v. Shiley, Inc.*, 819 P.2d 14, 17 (Cal. 1991); *Goodwine v. Superior Court*, 407 P.2d 1, 4 (Cal. 1965); *Union Carbide Corp. v. Aetna Cas. & Sur. Co.*, 562 A.2d 15, 19-20 (Conn. 1989); *Parvin v. Kaufmann*, 236 A.2d 425, 427 (Del. 1967); *Bland v. Norfolk & W. Ry. Co.*, 506 N.E.2d 1291, 1294 (Ill. 1987); *MacLeod v. MacLeod*, 383 A.2d 39, 41-42 (Me. 1978); *Varkonyi v. S.A. Empresa de Viacao Aereo Rio Grandense*, 239 N.E.2d 542, 544-45 (N.Y. 1968); *Chambers v. Merrell-Dow Pharm., Inc.*, 519 N.E.2d 370, 372-74 (Ohio 1988); *Zurick v. Inman*, 426 S.W.2d 767, 771 (Tenn. 1968). In some states, the doctrine of forum non conveniens has by now become part of statutory law. *E.g.*, ALA. CODE § 6-5-430 (LexisNexis 2005); LA. CODE CIV. PROC. ANN. art. 123 (1999); N.Y. C.P.L.R. 327 (McKinney 2001); 42 PA. CONS. STAT. ANN. § 5322(e) (West 2004); TEX. CIV. PRAC. & REM. CODE ANN. § 15.002(b) (Vernon 2002). *But see* *Harry S. Peterson Co. v. Nat'l Union Fire Ins. Co.*, 434 S.E.2d 778, 783 (Ga. Ct. App. 1993) (noting in dicta that dismissal on the grounds of forum non conveniens is an abuse of discretion).

44. The classic formulation of the forum non conveniens doctrine can be found in a decision by the U.S. Supreme Court, *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 507-09 (1947).

45. *Id.* In Delaware, a similar test is used. *Gen. Foods Corp. v. Cryo-Maid, Inc.*, 198 A.2d 681, 684 (Del. 1964) ("Thus proper to be considered are . . . (1) [t]he relative ease of access to proof; (2) the availability of compulsory process for witnesses; (3) the possibility of the view of the premises, if appropriate[;] and (4) all other practical problems that would make the trial of the case easy, expeditious and inexpensive. We add a further factor—whether or not the controversy is dependent upon the application of Delaware law which the courts of this State more properly should decide than those of another jurisdiction.").

Admittedly, the forum non conveniens doctrine is often applied in a restrictive manner. For example, under Delaware case law the trial court must find “overwhelming hardship” to the defendant for the case to be dismissed.⁴⁶ The fact that the only connection to the state of incorporation is the defendant’s status as a Delaware entity does not alter that test.⁴⁷ In other words, corporations that are incorporated in Delaware but are headquartered elsewhere cannot necessarily count on the forum non conveniens doctrine to save them from having to litigate third-party suits in Delaware courts.⁴⁸ Nonetheless, the forum non conveniens doctrine at least reduces the chance that a corporation will have to litigate in its state of incorporation despite the fact that it does not have any other ties to that state.⁴⁹

When sued in a federal court sitting in the state of incorporation, the corporation may also be able to raise the inconvenience of the forum chosen by the plaintiff. Under 28 U.S.C. § 1404(a), the district court, for the convenience of parties and witnesses, may transfer any civil action to any other district where the relevant action might have been brought.⁵⁰ This rule permits courts to grant transfers upon a lesser showing of inconvenience than under the old forum non conveniens doctrine.⁵¹ Hence, corporations with only a formal connection to the state of incorporation can hope that a federal court sitting in that state will transfer the action to a more appropriate forum.

2. The European Community

Once again, the situation is quite different in Europe. There, the Council Regulation precludes the application of the forum non

46. Taylor v. LSI Logic Corp., 689 A.2d 1196, 1198-99 (Del. 1997); Chrysler First Bus. Credit Corp. v. 1500 Locust L.P., 669 A.2d 104, 105 (Del. 1995); Kolber v. Holyoke Shares, Inc. 213 A.2d 444, 446-47 (Del. 1965).

47. Mar-Land Indus. Contractors, Inc. v. Caribbean Petroleum Ref., L.P., 777 A.2d 774, 782 (Del. 2001).

48. See *id.*

49. Dammann, *supra* note 2, at 496.

50. 28 U.S.C. § 1404(a) (2000). This provision “was apparently designed as an attempt to statutorily embody and modify the doctrine of *forum non conveniens*.” A.J. Indus., Inc. v. U.S. Dist. Court for the Cent. Dist. of Cal., 503 F.2d 384, 386 (9th Cir. 1974). Despite the enactment of 28 U.S.C. § 1404(a), the traditional forum non conveniens doctrine has not completely lost its importance in federal courts. It can still be applied in those cases where the defendant claims that the case ought to be litigated in a foreign forum. *E.g.*, Emily J. Derr, Note, *Striking a Better Public-Private Balance in Forum Non Conveniens*, 93 CORNELL L. REV. 819, 824 (2008).

51. Norwood v. Kirkpatrick, 349 U.S. 29, 31-32 (1955); Commercial Solvents Corp. v. Liberty Mut. Ins. Co., 371 F. Supp. 247, 249 (S.D.N.Y. 1974). It should be noted, however, that a transfer under § 1404 does not change the applicable substantive law. Ferens v. John Deere, 494 U.S. 516, 531 (1990).

conveniens doctrine.⁵² Accordingly, a corporation cannot avoid litigating in its state of incorporation by invoking the inconvenience of the forum.

C. *The Availability of Forum Selection Clauses*

Another factor that is pertinent to the risk of having to litigate in the state of incorporation lies in the availability of forum selection clauses. To the extent that a corporation can include such clauses in its contracts with third parties, it can reduce the risk of having to litigate in the state of incorporation. Admittedly, this protection is not absolute. In particular, there remains the risk of being sued by third parties, such as tort victims, who do not have any contractual relationship with the corporation. However, in practice, many disputes arise out of existing contractual relationships, such as with suppliers, creditors, customers, or employees.

Against this background, it is noteworthy that the availability of forum selection clauses is much greater in the United States than it is in the European Community.

1. The United States

In the United States, most state courts recognize forum selection clauses as valid.⁵³ As long as the clauses are reasonable and do not deprive the litigant of his day in court, such clauses will be respected both by the state that the parties have chosen as a forum⁵⁴ and by the state that would have exercised jurisdiction were it not for the forum

52. *E.g.*, Reinhold Geimer, *Art. 2 EG-VO Zivil-und Handelssachen (EuGVVO)*, in ZÖLLER ZIVILPROZESSORDNUNG 2706, 2709 (Reinhold Geimer et al. eds., 25th ed. 2005); Ulrich Magnus, *Art. 23*, in BRUSSELS I REGULATION 366, 388 (Ulrich Magnus & Peter Mankowski eds., 2007); Dammann, *supra* note 2, at 495. The same was true for the Brussels Convention. *See, e.g.*, Case C-281/02, *Owusu v. Jackson*, 2005 E.C.R. I-1383, I-1385, ¶¶ 37-46 (explaining why the Brussels Convention precludes the application of the forum non conveniens doctrine); Martine Stückelberg, *Lis Pendens and Forum Non Conveniens at the Hague Conference: The Preliminary Draft Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters*, 26 BROOK. J. INT'L L. 949, 962-64 (2001) (noting that the forum non conveniens doctrine cannot be applied under the Brussels Convention).

53. *But see* *Vanier v. Ponsoldt*, 833 P.2d 949, 959 (Kan. 1992) (holding that a “reasonable relationship” between the transaction and the selected forum is required); *In re Marriage of Yount*, 122 P.3d 1175, 1179 (Kan. Ct. App. 2005) (same); *Aylward v. Dar Ran Furniture Indus., Inc.*, 87 P.3d 341, 344 (Kan. Ct. App. 2004) (same). Even in states that consider outbound forum selection clauses invalid, the latter are sometimes deemed relevant to the application of the forum non conveniens doctrine. *E.g.*, *Davenport Mach. & Foundry Co. v. Adolph Coors Co.*, 314 N.W.2d 432, 437 (Iowa 1982).

54. *E.g.*, *Capital Group Cos. v. Armour*, C.A. No. 422-N, 2004 Del. Ch. LEXIS 159, at *23 (Del. Ch. Oct. 29, 2004); *Aon Corp. v. Utley*, 863 N.E.2d 701, 707 (Ill. App. Ct. 2006).

selection clause.⁵⁵ Accordingly, corporations are free to use forum selection clauses specifying that suits against the corporation are to be brought in the state where the corporation is headquartered rather than in its state of incorporation.

Similarly, corporations will often be able to use forum selection clauses to avoid having to litigate in a federal court sitting in the state of incorporation. Because they are thought to shed light on the interests of the parties, such clauses have to be given due consideration when a motion to transfer under 28 U.S.C. § 1404(a) is made.⁵⁶ While § 1404(a) calls for a weighing of various case-specific factors, a forum selection clause is thought to be a “significant factor that figures centrally in the district court’s calculus.”⁵⁷

2. The European Community

In Europe, the situation is more complicated. As a general matter, the Council Regulation allows the parties to choose a forum state by mutual agreement.⁵⁸ That choice is binding not only for the parties but also for all of the member states.⁵⁹ However, when it comes to consumer contracts, insurance contracts, and employment contracts, the freedom to enter into forum selection agreements is severely curtailed. With respect to consumer contracts, an agreement eliminating the state of incorporation as a forum for suits against the corporation is only valid if it is concluded after the dispute has arisen or if the agreement confers jurisdiction on the courts of a member state in which both parties are domiciled or habitually reside.⁶⁰ Similar restrictions apply to insurance contracts.⁶¹ In regard to employment

55. *See, e.g.*, *Societe Jean Nicolas et Fils, J.B. v. Mousseux*, 597 P.2d 541, 543 (Ariz. 1979) (holding that in the absence of fraud, a reasonable and fairly bargained-for-forum-selection clause will be enforced unless it deprives litigants of their day in court); *Parsons Dispatch, Inc. v. John J. Jerue Truck Broker, Inc.*, 199 S.W.3d 686, 690 (Ark. Ct. App. 2004) (enforceable unless “unreasonable and unfair.”); *Terry v. Student Transp. of Am., Inc.*, 557488, 2001 Conn. Super. LEXIS 3664, at *5 (Super. Ct. Dec. 14, 2001) (enforceable unless unreasonable); *Ex parte Soprema, Inc.*, 949 So. 2d 907, 912-14 (Ala. 2006) (enforceable unless unfair or unreasonable).

56. *See Stewart Org., Inc. v. Ricoh Corp.*, 487 U.S. 22, 29 (1988).

57. *Id.*

58. Council Regulation, *supra* note 12, art. 23(1).

59. *Id.*

60. *Id.* art. 17(3).

61. *Id.* art. 13(1)-(5) (providing that the Council Regulation’s rules on jurisdiction in insurance matters “may be departed from only by an agreement: 1. which is entered into after the dispute has arisen, or 2. which allows the policyholder . . . to bring proceedings in courts other than those indicated in this Section, or 3. which is concluded between a policyholder and an insurer, both of whom are . . . domiciled . . . in the same Member State . . . , or 4. which is concluded with a policyholder who is not domiciled in a Member State

contracts, the law is even stricter. A forum selection clause specifying that the employer corporation cannot be sued in its state of incorporation can only be concluded after the dispute has arisen, regardless of where the plaintiff resides.⁶²

D. *The Inconvenience of Litigation*

Finally, to the extent that a corporation has to litigate in its state of incorporation, the resulting inconvenience will often be greater in Europe than it is in the United States.

One obvious problem lies in the language barriers that European corporations face.⁶³ Admittedly, these language problems should not be exaggerated. The early leader in the European charter market appears to be the United Kingdom,⁶⁴ and English already is Europe's business language of choice.⁶⁵ Nonetheless, there is no question that some firms—particularly smaller ones—prefer using the native language of the country where they are located, especially where, as in a legal setting, minor misunderstandings can be of essence.

Another fairly obvious problem lies in the biases that corporations may face in the courts of the state of incorporation.⁶⁶ There are various reasons to believe that these biases will present a greater problem in Europe than they do in the United States. To begin, the relevant biases are quite simply likely to be stronger in Europe,

... , or 5. which relates to a contract of insurance in so far as it covers [one or more of a number of enumerated risks]).

62. *Id.* art. 21(2).

63. Dammann, *supra* note 2, at 502.

64. See Horst Eidenmüller, *Geschäftsleiter- und Gesellschafterhaftung bei europäischen Auslandsgesellschaften mit tatsächlichem Inlandssitz*, 58 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 1618, 1618 (2005) (F.R.G.) (noting that the English private company limited by shares has been particularly successful in the European charter market); Eidenmüller, *supra* note 6, at 192 (“It is already becoming clear that the United Kingdom and the Republic of Ireland will acquire a dominant position in [the European competition for corporate charters].”); Christoph Teichmann, *Reform des Gläubigerschutzes im Kapitalgesellschaftsrecht*, 59 NJW 2444, 2444 (2006) (noting the high number of English private limited companies that have been formed in Germany); cf. Marco Becht, Colin Mayer & Hannes F. Wagner, *Where Do Firms Incorporate? Deregulation and the Cost of Entry 2* (Eur. Corporate Governance Inst., Working Paper No. 70/2006, Aug. 2007), available at http://papers.ssrn.com/so13/papers.cfm?abstract_id=906066 (“Between 2003 and 2006 over 67,000 new private limited companies were established in the U.K. from other E.U. Member States.”).

65. Adam B. Cox & Eric A. Posner, *The Second-Order Structure of Immigration Law*, 59 STAN. L. REV. 809, 834 (2007) (noting that in many European countries, English is the de facto language of business).

66. Dammann, *supra* note 2, at 492-93.

where countries are divided by linguistic, cultural, and political barriers that go far beyond those that separate U.S. states.⁶⁷

Moreover, and perhaps more importantly, bias is likely to matter most in those cases in which the corporation, whose tie to the state of incorporation is a purely formal one, is sued by a local plaintiff. In the United States, that situation is likely to be rare. U.S. corporations that incorporate outside of their home state typically incorporate in Delaware. This is true not just for publicly traded firms⁶⁸ but also for closely held corporations.⁶⁹ Given Delaware's population of less than one million,⁷⁰ very few plaintiffs will ever be from Delaware.⁷¹ The situation is quite different in the European Community. There, the United Kingdom seems to be emerging as the early leader in the European charter market.⁷² Given the relatively large size of that country's population,⁷³ those firms that do business on a European scale stand a substantial risk that they will occasionally be sued by plaintiffs from the United Kingdom.

Finally, one has to take into account the incentives that judges in the state of incorporation face. Delaware courts are well aware of Delaware's dependence on franchise fees.⁷⁴ Hence, they are likely to be keen to avoid even the slightest hint of a bias against corporations

67. *Id.*

68. See Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1563 (2002) (noting that Delaware has a market share of ninety-five percent of those IPO firms that incorporate outside their home state).

69. See Jens Dammann & Matthias Schündeln, *The Incorporation Choices of Privately Held Corporations* 5 (Univ. of Tex. Sch. of Law, Law & Economics Research, Working Paper No. 119, 2007), available at <http://ssrn.com/abstract=1049581> (finding that of those privately held firms with more than twenty employees that are incorporated outside the state where their primary place of business is located, more than half incorporate in Delaware).

70. In 2006, the population of Delaware measured 853,476. U.S. Census Bureau, State and County Quick Facts, Delaware, <http://quickfacts.census.gov/qfd/states/10000.html> (last visited Apr. 19, 2008). At the same time, the total population of the United States was 299,398,484. *Id.*

71. Of course, many plaintiffs may "be from Delaware" in the sense that they are incorporated there. However, if the plaintiff is merely incorporated in Delaware without having any other connections to that state, then there is no risk that the plaintiff will be preferred over a defendant corporation that is also incorporated in Delaware.

72. See *supra* note 64 and accompanying text.

73. The population of the United Kingdom is now close to 60 million. Org. for Econ. Co-Operation & Dev., OECD.Stat-Extracts, <http://stats.oecd.org/wbos/viewhtml.aspx?queryname=335&querytype=view&lang=en59,989.2> (last visited Apr. 19, 2008).

74. In fact, that awareness has given rise to the claim that Delaware courts may put the interest of the state over the interests of shareholders. See William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 692 (1974) (suggesting that "Delaware may be characterized as a tight little club" and claiming that "participation in state politics and in the leading firms inevitably would align the Delaware judiciary solidly with Delaware legislative policy").

that are incorporated in Delaware but have their primary place of business elsewhere.⁷⁵ By contrast, while the United Kingdom may welcome the influx of foreign corporations, the relative importance that the charter market has for the United Kingdom is not particularly great given the size of the country's economy.⁷⁶ Accordingly, some U.K. courts may make less of an effort than their Delaware counterparts to appear unbiased.

In sum, the fact that corporations are exposed to litigation in their state of incorporation may not matter much in the United States. Accordingly, there is little reason to change the relevant law. In Europe, however, a different picture emerges. There, the rule whereby third parties can sue corporations in their state of incorporation is likely to impose a substantial burden on corporations.

IV. THE LACK OF A CONVINCING JUSTIFICATION

The question remains whether the burden that European law places on corporations by exposing them to litigation in their state of incorporation can be justified.⁷⁷ In this context, it is important to note that such a justification can be attempted on various grounds. Thus, one could try to reason that the rule at issue benefits the parties to a contract and therefore constitutes a desirable default rule. Alternatively, one could attempt to show that exposing corporations to litigation in the state of incorporation produces positive externalities or helps to reduce negative externalities. Finally, one could invoke fairness considerations. In the following Part, I argue that none of these approaches yields a convincing justification.

A. *The Interest of the Contracting Parties*

Consider, first, the costs and benefits to contracting parties. Does a rule exposing corporations to litigation in their state of incorporation benefit the parties, at least on balance? In answering this question it needs to be kept in mind that the parties can, at least in principle, opt

75. This second aspect basically restates part of Romano's commitment theory. According to Romano, one of the reasons for Delaware's success in the market for corporate charters resides in its financial dependence on franchise fees, because this dependence ensures Delaware's future responsiveness to corporate needs. See Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 279-81 (1985) (arguing that Delaware's dependence on incorporation fees tends to explain its popularity as a state of incorporation).

76. For 2005, the GDP of the United Kingdom was estimated at \$1.9 trillion. Org. for Econ. Co-Operation and Dev., *supra* note 73.

77. I speak of "European" law here because, as mentioned in Part II.A., the relevant burden results from a combination of Community law and member state law.

out of the rules governing the available forums. Hence, in order to determine whether or not the rule at issue benefits contracting parties, one can resort to the well-developed literature on the efficiency of default rules.

1. Transaction Costs

The traditional approach to default rules has been to choose those rules that the parties would have agreed to had they bargained in the absence of transaction costs.⁷⁸ Needless to say, different parties might prefer different rules. Hence, at best, one can select the rule that the most parties would have agreed upon.⁷⁹ The obvious attraction of this solution is that it minimizes the number of cases in which the parties have to opt out of the default in order to arrive at their preferred solution. Assuming that all defaults are equally easy to opt out of, transaction costs are minimized.⁸⁰

In the case at hand, there are various forums that the parties are likely to find particularly suitable. They may find it advantageous to pick the state where at least one of the parties has its principal place of business or central administration in order to reduce the costs of litigation. Or they may pick the state where the events giving rise to the cause of action occurred, given that that state may be particularly convenient for fact-finding purposes. Finally, they may choose a state that has no ties to either party and therefore constitutes a “neutral forum.” By contrast, it is not clear what motivation would drive them to settle on the corporate defendant’s state of incorporation where that state deviates from the state in which the corporation has its central administration and principal place of business. In other words, there is no reason to believe that in the absence of transaction costs, a majority of parties would choose the state of incorporation as an additional or exclusive forum for lawsuits against the corporation.

While one can often minimize transaction costs by choosing the arrangement that the most parties would have agreed upon anyway, Ian Ayres and Robert Gertner have pointed out that there is an

78. *E.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 15 (1991) (“[C]orporate law should contain the terms people would have negotiated.”); Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 835-36 (1985) (“[F]raudulent conveyance law . . . should provide all the parties with the type of contract that they would have agreed to if they had . . . bargain[ed].”).

79. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 93 (1989) (using the term *majoritarian defaults* to refer to default rules of this type).

80. *Id.* at 90.

exception to this rule.⁸¹ Some legal defaults may be easier to contract around than others. In this case, the default that minimizes transaction costs may be the one that the parties can opt out of most easily.⁸²

Once this factor is taken into account, the case against the rule that designates the state of incorporation as a forum for suits against the corporation becomes even stronger, assuming that one is unwilling to revise the Community rules on forum selection clauses.⁸³ Given the existing rules on forum clauses, it is much easier for the parties to add the state of incorporation as an additional forum than to eliminate that state from the list of available forums. As a rule, Community law does not prevent the parties from inserting into their contract a forum selection clause specifying that, in addition to the other available forums, the corporation can be sued in its state of incorporation.⁸⁴ By contrast, in cases of consumer, insurance, or employment contracts, it is difficult for the parties to eliminate the forums that the Council Regulation provides.⁸⁵ For example, in employment contracts, such opt outs are possible only after the dispute has arisen.⁸⁶ The same is true for consumer contracts unless both parties are domiciled or habitually reside in the same member state.⁸⁷ A similar rule exists for insurance contracts.⁸⁸

Needless to say, once a conflict between the parties has arisen, opting out of the legal default likely becomes more costly and difficult. This is due to a number of factors. To begin with, an already existing conflict does not make bargaining any easier. In addition, there are time constraints. Plaintiffs, anxious to prevent a deterioration of the

81. Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391, 1403-08 (1992) (book review) (arguing that it may be efficient to choose a default rule that only a minority of parties want if that default rule is cheaper to contract around than the alternative); Ayres & Gertner, *supra* note 79, at 93 (pointing out the possibly disparate costs of contracting and of failing to contract around different defaults).

82. *See* Ayres, *supra* note 81, at 1405.

83. One could, of course, loosen the restrictions that the Council Regulation places on the availability of forum selection clauses in consumer contracts. However, such an approach would have costs of its own. In particular, parties such as consumers, employees, and insurance takers will often fail to study the contract's fine print *ex ante*.

84. The Council Regulation generally allows forum selection clauses except in those cases where the Council Regulation confers exclusive jurisdiction upon the courts of a member state. Council Regulation, *supra* note 12, art. 23(1), (5).

85. The Council Regulation restricts the use of such clauses in insurance contracts, consumer contracts, and employment clauses. *Id.* arts. 13, 17, 21. However, these provisions do not prohibit the use of forum selection clauses that merely increase the number of forums that are available for suits brought by the insurance taker, consumer, or employee. *See id.*

86. *Id.* art. 21.

87. *Id.* art. 17.

88. *Id.* art. 13.

evidence and to avoid running afoul of statutes of limitations, may want to litigate as soon as possible and may therefore be reluctant to spend time negotiating the forum. Furthermore, by the time the parties can start to negotiate the forum, the plaintiff may already have consulted a lawyer. This poses two problems. First, the decision to litigate in a state other than the one originally envisioned may make it necessary to involve a different lawyer, thereby devaluing the original lawyer's efforts to get acquainted with the case. Second, and even more importantly, the plaintiff's original lawyer may be faced with a conflict of interest leading her to advise her client against agreeing to another forum. After all, if another forum is chosen, the plaintiff's original lawyer may either be replaced or at least forced to cooperate with—and possibly share her fees with—a lawyer admitted to the bar in the new forum state.

In sum, under the existing rules on forum selection clauses, it is much easier to add the state of incorporation as an additional forum for suits against the corporation than to eliminate that state from the list of available forums. This, too, suggests that a rule exposing corporations to litigation in the state of incorporation should not represent the default.

2. Informational Asymmetries

Ayres and Gertner have pointed out yet another consideration that may guide the legislature in choosing defaults. Replacing the legal default with a more efficient contractual rule may sometimes require one of the parties to disclose information that would reduce her own gains from contracting even as it increases the parties' combined gains from contracting.⁸⁹ As a result, the party in question may be willing to retain a moderately inefficient default rule rather than abandon it in favor of a more efficient contractual one.⁹⁰ In such a case, it may be efficient to choose a default that the better informed party finds particularly unattractive. That way, the better informed party is given a stronger incentive to contract around the default and, in the process, to disclose information to the other side. As a result, the informational

89. See Ayres & Gertner, *supra* note 79, at 94 (pointing out that one party might strategically withhold information that would increase the total gains from contracting in order to increase her private share of the gains from contracting).

90. See *id.* at 100 (“[A] party who knows that a particular default rule is inefficient may choose not to negotiate to change it. The knowledgeable party may not wish to reveal her information in negotiations if the information would give a bargaining advantage to the other side.”).

asymmetries are reduced, and the combined gains from contracting increase.⁹¹

How, then, can a situation arise in which one of the parties has an incentive to withhold information even though sharing it would increase the combined gains from contracting? Ayres and Gertner point to the following set of facts.⁹² One party's atypical situation may be unknown to the other party, allowing the informed party to blend in with a larger class of typical cases.⁹³ As a result, the uninformed party will bargain as though dealing with a typical case, which may result in more attractive conditions for the informed party.⁹⁴ Naturally, the conditions offered by the uninformed party will reflect the fact that some cases are atypical. Thus, the informed, atypical party is cross-subsidized by the typical members of her class.⁹⁵ As a result, the informed party may be unwilling to opt out of the legal default, even if such a move would increase the combined gains from contracting.⁹⁶ That is because in order to deviate from the legal default, the informed party would have to disclose her atypical situation to the other side, thereby losing the relevant cross-subsidies.⁹⁷

These considerations are not without relevance to the problem at hand. Corporations that are incorporated outside of their home state, i.e., outside the state where their principal place of business or central administration is located, will often prefer to litigate in their home state. If the corporation cannot distinguish between those of its contractual partners that will later bring suit in the corporation's home state and those that will bring suit in the corporation's state of incorporation, the corporation will be forced to offer the same conditions to both. As a result, parties of the second type will be cross-subsidized by parties of the first type.

Admittedly, even under existing law, there are two factors that mitigate the problem at hand. First, the corporation will often be able to use forum selection clauses designating the state of its principal place of business as the sole forum for suits against the corporation. That way, contractual parties who prefer to sue the corporation in its state of incorporation are forced to identify themselves by declining to

91. *See id.* at 98 (arguing that the goal of informing the "relatively uninformed contracting party" may justify a default rule that burdens the "relatively informed contracting party").

92. *Id.* at 100.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

agree to the relevant forum selection clause. Moreover, if a party prefers to litigate in the state of incorporation, this will often be due to the fact that the party is domiciled in—or at least geographically close to—the corporation's state of incorporation. Given that the corporation often knows where its contractual partners are domiciled, it can to some extent predict the likelihood that they will prefer the state of incorporation as a forum.

This said, the two aforementioned factors cannot completely resolve the problem at issue. As has already been pointed out, when it comes to employment, consumer, and insurance contracts, Community law severely curtails the freedom to use forum selection clauses.⁹⁸ Moreover, at least in over-the-counter contracts, the other party's residence will not always be known to the corporation. Accordingly, corporations may well find themselves in a position where they cannot distinguish between those parties that are likely to make use of the right to sue the corporation in its state of incorporation and those that are not.

Abolishing the rule under which the corporation can be sued in its state of incorporation even in the absence of other contacts with that state would solve this problem. Those parties who prefer to litigate in the state of incorporation would then have to insist upon a forum selection clause designating that state as a forum. As a result, the corporation could bargain accordingly.

In sum, there is no reason to believe that the existing legal framework which exposes corporations to litigation in their state of incorporation can be justified on the basis that it increases the parties' gains from contracting.

B. Reducing Externalities

The question remains whether exposing corporations to litigation in their state of incorporation can be justified on the grounds that it produces positive externalities or helps to reduce negative ones. In this context, it should first be noted that even if the rule at issue had these effects, this would still not necessarily imply its desirability. Rather, one would have to weigh the relevant benefits against the burden that this rule imposes on corporations. The point is moot, however, because it is not clear that the rule at issue produces substantial positive externalities or helps to avoid substantial negative externalities.

98. See *supra* notes 58-61 and accompanying text.

1. Reducing the Burden on Courts

Regarding the avoidance of negative externalities, one could try to invoke the following argument made in the literature on default rules: legal default provisions may be more costly to apply than contractual provisions dealing with the same issue.⁹⁹ This is because the legal default rule will often have to be abstract—thereby putting a burden on the court—whereas the parties can be more specific in choosing the desired contractual rules. Given that courts are often subsidized, some of the relevant costs are borne by the state.¹⁰⁰ Accordingly, from the point view of society as a whole, the parties may have an insufficient incentive to contract around legal default rules.¹⁰¹

To remedy this situation, two options offer themselves. One is to choose a so-called penalty default that both parties find unattractive.¹⁰² Such a rule gives the parties an additional incentive to contract around the default.¹⁰³ Another, even simpler option is to choose a default rule that is as easy to apply as any contractual rule the parties might choose. If such a rule is chosen, the decision of the parties to opt out or to refrain from opting out no longer has any influence on the costs incurred by the court. Thus, no negative externalities occur.

To some extent, these considerations may seem to run in favor of a rule designating the state of incorporation as a default forum. It can sometimes be difficult to ascertain where a corporation's primary place of business and central administration are located.¹⁰⁴ A rule designating the state of incorporation as a forum state would certainly give corporations that lack other ties to the state of incorporation a powerful incentive to opt out. Moreover, such a rule would be particularly easy to apply.

However, the weight of these considerations seems marginal at best. Most of the costs of litigation, particularly the fees charged by

99. See Ayres & Gertner, *supra* note 79, at 93.

100. *Id.*

101. *Id.* at 94.

102. *See id.*

103. *See id.*

104. See Lea Brilmayer et al., *A General Look at General Jurisdiction*, 66 TEX. L. REV. 721, 734-35 & n.62 (1988) (pointing out that the principal place of business may be hard to determine); Mary Twitchell, *The Myth of General Jurisdiction*, 101 HARV. L. REV. 610, 676-79 (1988) (pointing out that it can be difficult to determine a corporation's headquarters); Michael J. Whincop, *Conflicts in the Cathedral: Towards a Theory of Property Rights in Private International Law*, 50 U. TORONTO L.J. 41, 51 (2000) (pointing out that the principal place of business of a multinational corporation may be hard to determine); *cf.* Toms v. Country Quality Meats, Inc., 610 F.2d 313, 315-16 (5th Cir. 1980) (describing various tests for determining a corporation's principal place of business for diversity purposes).

attorneys, are borne by the parties. Moreover, while the locations of the corporation's principal place of business and central administration may sometimes be difficult to determine, that is unlikely to be the rule, especially where the corporation only has a single place of business. In addition, it must be kept in mind that the present regime does not designate the state of incorporation as the only forum. Rather, Community law only adds the state of incorporation to the other available forums that include the states where the corporation's central administration and primary place of business are located.¹⁰⁵ Accordingly, the need to determine the locations of the corporation's central administration and primary place of business may still arise, namely in those cases where the plaintiff brings suit in a state other than the state of incorporation.

In sum, the fact that the state of incorporation may be easier to ascertain than the location of the corporation's central administration or primary place of business hardly offers a plausible justification for the present regime.

2. Providing States with an Incentive to Compete for Corporate Charters

A somewhat more plausible argument in favor of the present regime is that exposing corporations to litigation in the state of incorporation produces positive externalities in that it provides states with an additional incentive to compete for corporate charters.

The reasoning underlying this argument is as follows: to the extent that corporations have to litigate in the state of incorporation, this will create additional business for the local bar. Accordingly, local litigators will lobby the government to compete more energetically for corporate charters. Moreover, the state government may welcome the additional tax revenues that result from the additional income that local lawyers gain. It follows that exposing corporations to litigation in their state of incorporation will lead states to increase their efforts to attract corporate charters. That, in turn, will benefit shareholders if one assumes—as this Article does—that the benign view of state competition is correct.

Attractive as that argument may seem, though, a closer examination reveals that it has considerable weaknesses. To begin with, it is not clear to what extent the rule at issue actually increases the volume of litigation in the state of incorporation. Those corporations for whom the relevant rule actually brings a substantial

105. See *supra* notes 14-17 and accompanying text.

increase in the risk of having to litigate in the state of incorporation may react by remaining incorporated in the state where their primary place of business is located.¹⁰⁶ Moreover, other corporations may make considerable efforts to minimize the risk of having to litigate in the state of incorporation via forum selection clauses. While this strategy has its limits,¹⁰⁷ it will still reduce the number of cases in which the corporation can be sued in its state of incorporation. Admittedly, none of this means that there will be no increase in litigation in the state of incorporation. However, that increase may be relatively small given the overall volume of civil litigation in the relevant state. That is particularly true because the United Kingdom, the early leader in the market for corporate charters,¹⁰⁸ is a relatively large member state with no shortage of homegrown cases.¹⁰⁹

Moreover, even assuming that exposing corporations to litigation in their state of incorporation will increase the volume of litigation in that state, it is not necessarily clear that this will drive states to compete for corporate charters. Admittedly, both in the United States and in Europe it is widely and, in my view, rightly assumed that one reason to compete for corporate charters is to generate business for the local bar.¹¹⁰ However, there is reason to question whether the litigation

106. The fact that the United Kingdom has attracted many corporations whose primary place of business is located in other member states does not refute this argument. As Becht, Colin, and Wagner point out, most of the firms from other member states who have chosen to incorporate in the United Kingdom are very small. *See* Becht, Colin, & Wagner, *supra* note 64, at 2 (“Most of the new foreign Limited companies are small entrepreneurial firms.”).

107. *See supra* Part III.C.

108. *See* sources cited *supra* note 64.

109. Detailed data on the number of cases filed in the various courts and tribunals of the United Kingdom can be found in SECRETARY OF STATE FOR JUSTICE AND LORD CHANCELLOR, JUDICIAL AND COURT STATISTICS 2006, at 7-178 (2007), available at <http://www.official-documents.gov.uk/document/cm72/7273/7273.pdf>.

110. Regarding the United States, see, for example, Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1443 (1992) (“Incorporations . . . provide patronage for local law firms. . . .”); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQ. L. 387, 512 (2001) (noting that local bars encourage statutory reforms to drive local charters to their states); Romano, *supra* note 75, at 240-41 (stating that the Delaware corporate bar “earn[s] substantial income” from Delaware corporations). Kahan and Kamar estimate that Delaware’s lawyers derived additional income in the amount of \$165 million dollars from Delaware’s position in the market for corporate charters. Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 697-98 (2002). This is a nontrivial amount given that in the same year, Delaware’s revenues from franchise taxes were around \$586 million. U.S. Census Bureau, State Government Tax Collections: 2001 (Revised April 2003), <http://www.census.gov/govs/statetax/0108destax.html>.

at issue here could fulfill a similar function. The benefits that Delaware's lawyers derive from the charter market seem to be mainly due to the fact that corporations litigate their internal affairs in Delaware.¹¹¹ Similarly, it is legal business relating to the internal affairs of corporations that scholars hope will motivate the member states of the European Community to compete for corporate charters.¹¹²

By contrast, what is at stake in this Article is the ability of *third parties* to sue the corporation in its state of incorporation. In other words, it is litigation pertaining to the external affairs of corporations that is at stake. This difference matters because it is highly relevant to the question of how profitable the relevant cases are likely to be for litigators in the state of incorporation.

Consider the cases that have proven so profitable for Delaware's lawyers and that may prove equally profitable for their European peers once the European charter market has fully developed. Delaware has proven particularly successful at attracting large corporations. More than half of all publicly traded corporations are incorporated in Delaware,¹¹³ and Delaware also enjoys great popularity among large closely held corporations.¹¹⁴ Not surprisingly, therefore, Delaware's Chancery Court has become the leading forum for high-stakes corporate law cases.¹¹⁵ Crucially, these cases do not end up in

As regards Europe, the desire to create business for local lawyers will likely suffice to drive the member states to compete for corporate charters. See Dammann, *supra* note 2, at 521-24; see also John Armour, *Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition*, in AFTER ENRON 497, 520 (John Armour & Joseph M. McCahery eds., 2006) (arguing that "the UK's legal profession is . . . much better placed to spur regulatory competition than is Delaware's").

111. Significantly, it has been estimated that three-quarters of the workload of the Chancery Court consists of corporate law cases. E.g., Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 903 (1990); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1077-78 (2000); cf. Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1212 (2001) (stating that the docket of the Chancery Court "consists mostly of corporate claims").

112. E.g. Dammann, *supra* note 2, at 521-24; Armour, *supra* note 110, at 497, 520.

113. State of Del., Department of State: Division of Corporations, <http://www.state.de.us/corp> (last visited Apr. 19, 2008).

114. See Dammann & Schündeln, *supra* note 69, at 5 (noting that of those closely held corporations that have at least 1000 employees and are not incorporated in the state of their principal place of business, about eighty percent are incorporated in Delaware).

115. E.g., Yan Leychikis, *Of Fire Ants and Claim Construction: An Empirical Study of the Meteoric Rise of the Eastern District of Texas as a Preeminent Forum for Patent Litigation*, 9 YALE J.L. & TECH. 193, 229 (2007) (calling the Delaware Chancery Court a "preeminent forum for corporate litigation"); William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 BUS.

Delaware simply because Delaware is willing to exercise jurisdiction over suits brought against domestic corporations. After all, a corporation could easily insert into its charter a provision specifying a different forum for lawsuits pertaining to the corporation's internal matters. Rather, the fact that these cases are litigated in Delaware demonstrates that Delaware's Chancery Court is perceived to be a particularly desirable forum for corporate law cases.¹¹⁶

By contrast, the cases at issue here are of a very different type. Exposing corporations to litigation in the state of incorporation may not significantly increase the number of high-stakes cases being litigated in popular states of incorporation. The reason is quite simple. In practice, high-stakes contracts are usually much more carefully negotiated than low-stakes contracts because where the stakes are high, the transaction costs incurred in negotiating and drafting contracts matter less.¹¹⁷ Accordingly, the parties to high-stakes transactions are likely to make a conscious choice regarding the forum. Either they opt out of the rule, allowing the corporation to be sued in its state of incorporation, or they fail to opt out because they *want* their state of incorporation to be an available forum. In other words, the fact that the legal default exposes corporations to litigation in their state of incorporation is unlikely to affect many high-stakes cases.

It follows that the rule at issue is mainly relevant to cases in which the stakes are limited. These cases, however, are less attractive to attorneys in the state of incorporation. Consequently, attorneys may not lobby very hard to increase the volume of such cases. And, just as importantly, attracting cases of the type at issue may not seem appealing to lawmakers in the state of incorporation.¹¹⁸ After all, additional litigation does not just bring additional business for domestic lawyers and additional tax revenues. Rather, it also increases

LAW. 351, 354 (1992) (pointing to the "national preeminence [of Delaware's court system] in the field of corporation law").

116. Cf. ROMANO, *supra* note 6, at 41 (pointing out that twenty-nine out of a sample of thirty-five shareholder lawsuits that involved Delaware corporations and could have been filed either in federal courts or in Delaware state courts ended up being filed in Delaware state courts).

117. Cf. Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1984 (2006) (arguing, with respect to their data set, that "[b]ecause the contracts [in the data set] are important to the reporting firm's operations, we can assume that they receive some degree of care and attention during the negotiation and drafting phase").

118. Indeed, quite generally, it appears that states show little inclination to compete for foreign litigants in those cases where the amount at stake is limited. See Jens Dammann & Henry Hansmann, *Globalizing Commercial Litigation*, 94 CORNELL L. REV. (forthcoming 2008).

the burden on—often subsidized—local courts and may result in longer delays for other litigants. These drawbacks may not weigh very heavily when it comes to cases that are particularly profitable for local lawyers, but low-stakes cases of limited profitability may well be a different matter.

Accordingly, even assuming that exposing corporations to litigation in their state of incorporation increases the volume of litigation in that state, it is not at all clear that this will motivate states to compete more vigorously for corporate charters.

C. *Fairness*

Can a rule exposing corporations to litigation in their state of incorporation be justified on fairness grounds?

It has been pointed out that the act of incorporating in a given state should suffice to confer general jurisdiction on that state because the corporation has intentionally created a relationship with that state in order to obtain the benefits of that state's laws.¹¹⁹ Quite apart from its doctrinal significance for the Due Process Clause of the U.S. Constitution, one may be tempted to invoke this line of reasoning as a fairness argument. Is it not fair, one might ask, that a corporation which avails itself of the benefits that a particular jurisdiction has to offer should also be subject to litigation in that jurisdiction?

Indeed, in some contexts, the idea that one should not be able to cherry-pick certain aspects of a legal system may exude a certain charm.¹²⁰ For example, assume that most jurisdictions tend to create legal systems that are more or less fair, but only if they are applied in their entirety rather than selectively.¹²¹ Further, assume that the parties to choice-of-law agreements cannot be expected to protect themselves, for example, because of informational asymmetries. In that case, if the parties choose another jurisdiction's law in their contract, it may seem

119. See Brilmayer et al., *supra* note 104, at 733 (asserting that “the decision to incorporate in a particular state provides a . . . powerful basis for adjudicatory jurisdiction” and giving, *inter alia*, the reason that “the corporation intentionally chooses to create a relationship with the state of incorporation, presumably to obtain the benefits of that state’s substantive and procedural laws”).

120. See Erin A. O’Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151, 1192-94 (2000) (describing the apparent advantages of “bundling” different states’ laws).

121. *Cf. id.* at 1193 (“[L]egislators may enact a given law only because of its expected interaction with a complementary law.”).

appropriate to require that the relevant substantive law be selected in its entirety.¹²²

However, whatever the merits of this argument may be in other contexts, it does not apply to the problem at hand. One might be tempted to argue that a jurisdiction's substantive law on the one hand, and its procedural law and courts on the other hand, are parts of the same legal system and that corporations should not be able to choose one without the other.¹²³ However, even if one were to embrace that principle, a rule exposing corporations to third-party suits in the state of incorporation would not be justified. Such a rule increases rather than decreases the risk that a corporation will be subject to the substantive law of one jurisdiction while litigating in the courts of another jurisdiction. Under the law of the European Community, a corporation's relations with third parties are not generally governed by the law of the state of incorporation. Rather, they are, in principle, governed by the law of the member state with which the contract is most closely connected.¹²⁴ Usually, that is the member state where the party who effects its characteristic performance, has its habitual residence or, in the case of a corporation, its central administration.¹²⁵ Accordingly, the best way to ensure that corporations litigate in the courts of the state whose substantive law governs the case is to abstain from exposing corporations to third-party suits in the state of incorporation.

In sum, it is not particularly persuasive to invoke fairness considerations to justify exposing corporations to third-party suits in their state of incorporation. Given the lack of other plausible justifications, it seems fair to conclude that the rule at issue simply cannot be justified convincingly.

122. *Id.* at 1192 (arguing that if parties to choice-of-law agreements are prevented from combining different foreign laws, this “may help prevent bargaining or information disparities from influencing the choice”).

123. *Id.* at 1194 (considering a rule under which a state's procedural law and substantive law have to be chosen as a bundle, but ultimately opposing it because “[t]he forum has a strong comparative regulatory advantage regarding procedural rules” and because “permitting a court to operate under a single set of procedural rules enhances judicial economy”).

124. Convention on the Law Applicable to Contractual Obligations (Consolidated Version), 1998 O.J. (C 27) 34 art. 4(1) (EC) (providing that if the parties have failed to choose the applicable law, “the contract shall be governed by the law of the country with which it is most closely connected”).

125. *Id.* art. 4(2).

V. WHAT MIGHT A REFORM LOOK LIKE?

The drawbacks of the current system suggest that the rules exposing European corporations to litigation in the state of incorporation should be reformed.

A. *Possible Steps*

Because of the way in which Community law interacts with member state law, there are two main ways of remedying the present situation. The first requires legislative action by each member state. The member states could allow domestic corporations to choose a statutory seat that was located in the state where the corporation's primary place of business or central administration was located—even if that state was not the same as the state of incorporation. That way, corporations could still be sued in the state where their statutory seat was located. However, this would no longer matter because the statutory seat would be in the same state where the corporation's principal place of business or central administration was situated. Alternatively, one could change Community law. For example, one could add a provision to the Council Regulation according to which, for the purpose of third party suits against the corporation, a corporation's statutory seat was insufficient to create a domicile.

B. *Reforms at the State Level Versus Reforms at the Federal Level*

Which of the two aforementioned approaches should be chosen is a matter that I consider to be of secondary importance. Nonetheless, a few comments are in order. As pointed out above, this Article assumes that the freedom of corporations to choose the applicable corporate law is desirable.¹²⁶ Those who share that view will generally subscribe to the logically distinct but related view that, as a general matter, corporate law is better left to the states.¹²⁷

Of course, if one believes—as I do—that corporate law should generally be the domain of the states, then the prospect of solving the problem at hand via reforms at the state level has a certain attraction: it does not interfere with the autonomy of the member states. Rather,

126. See *supra* note 6 and accompanying text.

127. Cf., e.g., Dammann, *supra* note 2, at 542 (concluding that “free choice is both a viable and desirable policy choice for the European Community”); Luca Enriques & Matteo Gatti, *The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union*, 27 U. PA. J. INT'L ECON. L. 939, 943-45 (2006) (arguing against harmonization of EU corporate law); Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REG., Spring 2003, at 26, 30-31 (summarizing the arguments against federal intervention in the area of corporate law in the United States).

it would be left to the member states to decide whether or not to subject corporations to litigation in the state of incorporation by forcing them to choose a statutory seat that is located within the state of incorporation's territory.

By contrast, if one were to reform Community law in the manner described above, this would further reduce the regulatory autonomy of the member states. After all, under such an approach, the state of incorporation could no longer exercise general jurisdiction over domestic corporations whose principal place of business and central administration are located elsewhere.

At the same time, the issue at hand is one of those cases where state competition for corporate charters may not be sufficient to produce optimal results.¹²⁸ One should certainly not attach too much importance to the fact that the reforms suggested in this Article have not already been adopted. After all, regulatory competition in European corporate law is still a relatively novel phenomenon.¹²⁹

However, quite apart from the present state of the law, there is another reason to doubt that states will be willing to change the status quo: lawyers in the state of incorporation will, all else equal, prefer a rule that exposes corporations to litigation in that state. And as has long been known, lawyers in the state of incorporation can form a powerful interest group.¹³⁰ Hence, where the interests of lawyers in the state of incorporation diverge from those of shareholders, the former's influence can lead the state of incorporation to enact norms that fail to maximize shareholder wealth.¹³¹ In the case at hand, this danger should not be exaggerated. For the reasons outlined above,¹³² it seems unlikely that lawyers in popular states of incorporation will lobby hard to preserve the rule at issue. Nonetheless, one cannot be

128. Even the adherents of state competition in corporate law tend to concede that such competition cannot be expected to produce perfect results. See, e.g., ROMANO, *supra* note 1, at 93 (pointing out that "advocates of charter competition . . . do not contend that state competition is perfect"); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2385 (1998) ("This is not to say that state competition is perfect").

129. Cf. Dammann, *supra* note 2, at 483-86 (describing how the European Court of Justice, in a series of groundbreaking judgments starting with the *Centros* judgment in 1999, has eliminated the main obstacle to state competition in the European Community).

130. Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 506-07 (1987) (listing the various factors that turn the Delaware bar into a powerful interest group).

131. Cf. *id.* at 505 (pointing out that the Delaware bar "has some interest in reducing the clarity of Delaware law to enhance the amount of litigation" even though this may deter some corporations from incorporating in Delaware).

132. Part IV.B.1.a (explaining why litigation in the state of incorporation that results from the rule at issue may not be overly important to lawyers in that state).

sure that the member states will adopt the reforms suggested in this Article. Accordingly, it may turn out that a change at the level of Community law is needed.

VI. CONCLUSION

Both in the United States and in the European Community, corporations are exposed to litigation in their state of incorporation even if they have no other ties to that state.

In the United States, the relevant rules may only have a limited practical impact. In many cases, such rules will not constitute the only basis on which the courts of the state of incorporation can exercise jurisdiction. Moreover, corporations will often be able to protect themselves by using forum selection clauses in their contracts. Even in the absence of forum selection clauses, corporations may sometimes be able to invoke the *forum non conveniens* doctrine to avoid having to litigate in the state of incorporation.

By contrast, the Community rule that exposes European firms to litigation in their state of incorporation is likely to be much more burdensome. Such a rule is more likely in Europe than in the United States to allow the courts of the state of incorporation to exercise jurisdiction where they could not have done so otherwise. In many cases, European corporations cannot use forum selection clauses to eliminate the risk of being sued in their state of incorporation. Nor can they invoke the inconvenience of the forum in order to protect themselves against having to litigate in the state of incorporation.

Moreover, the burden that the rule at issue places on European corporations cannot be justified convincingly. It does not promise to increase the combined gains reaped by contracting parties. It is highly unlikely to achieve either a substantive increase in positive externalities or a significant reduction in negative externalities. Finally, it cannot even be justified persuasively on fairness grounds.

Against this background, it would be desirable to change the existing legal framework in the European Community. The fact that a corporation is incorporated in a particular member state should not suffice to expose the corporation to third-party suits in that state.