The Internal Affairs Doctrine in Alabama

By Jay M. Ezelle and C. Clayton Bromberg, Jr.

The Alabama Supreme Court's recent opinion in *Ex parte Bentley*[1] helps clarify the choice of law determination for internal disputes of foreign companies. Although Alabama has long recognized the principle that the law of the state of incorporation governs internal corporate relationships, Alabama courts have occasionally applied Alabama law to the internal affairs of a business. Therefore, counsel involved in a business dispute must be diligent to ensure that the court makes the correct choice of law determination. *Bentley*, as well as the decisions cited therein, provides strong precedent that internal business disputes should be decided based on the law of the state of organization.

Internal Affairs Doctrine

A business is free to organize itself under the law of any state regardless of where it will be physically located or where it will transact business. The state of incorporation or organization generally has the exclusive right to regulate the "internal affairs" of the business. This exclusive right is known as the Internal Affairs Doctrine.[2] The Alabama Supreme Court has defined "internal affairs" as follows:

> [W]here the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholder's meeting, or through its agent, the board of directors, that then such action is the management of the internal affairs of the corporation…[3]

The purpose of the Internal Affairs Doctrine is to prevent inconsistent regulations of business in different states.[4] The doctrine protects the expectations of those involved with the internal affairs of the business by providing a level of predictability regarding the law that governs the business. Much like the terms of a contract that sets forth governing law, and therefore provides the parties a greater level of predictability as to how the contractual terms will be interpreted, applying the law of the organizational forum provides a greater level of certainty of the legal obligations of those who choose to be a part of a business organization.

Almost every state employs some version of the Internal Affairs Doctrine.[5] One of the leading cases on the Internal Affairs Doctrine is *VantagePoint Venture Partners 1996 v. Examen, Inc.*[6] In *VantagePoint*, the Delaware Supreme Court set forth three reasons for the application of the Internal Affairs Doctrine without exception. First, there is strong precedent from both the Delaware Supreme Court and the United States Supreme Court supporting the Internal Affairs Doctrine. The Delaware Supreme Court held that it "[i]s a long-standing choice of law principle

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which recognizes that only one state should have the authority to regulate a corporation's internal affairs—the state of incorporation."[7]

Second, the Internal Affairs Doctrine is supported by important public policy because it "prevent[s] corporations from being subjected to inconsistent legal standards..." and provides certainty and predictability.[8] The Delaware Supreme Court also relieved heavily on the United States Supreme Court's discourse on the public policy underpinning the Internal Affairs Doctrine:

> It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.[9]

Third, the Delaware Supreme Court held in *VantagePoint* that application of the Internal Affairs Doctrine is mandatory under the Fourteenth Amendment Due Process Clause because "[d]irectors and officers of corporations 'have a significant right...to know what law will be applied to their actions' and 'stockholders...have a right to know by what standards of accountability they may hold those managing the corporation's business and affairs,'" and under the Commerce Clause because "[a] state 'has no interest in regulating the internal affairs of foreign corporation.'"[10] In fact, the Delaware Supreme Court held that the only time that application of the Internal Affairs Doctrine is not required is the rare instance when "'the law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce.'"[11]

Internal Affairs Doctrine in Alabama

The State of Alabama has adhered to the Internal Affairs Doctrine since 1921, when the Alabama Supreme Court first held that the laws of Delaware regulated the relationship among shareholders in a corporation formed under the laws of the state.[12] In *Massey v. Disc Mfg., Inc.*, the Alabama Supreme Court stated that "the established rule of conflicts law is that the internal corporate relationship is governed by the law of the state of incorporation."[13] Likewise, the Internal Affairs Doctrine is adopted by statute in Alabama. *Alabama Code* § 10-2B-15.05 precludes any attempt by the State "[t]o regulate the organization or the internal affairs of a foreign corporation authorized to transact business in [Alabama]."[14]

Nevertheless, there have also been lawsuits involving the internal affairs of a business organized in another state in which the Alabama Supreme Court chose to apply Alabama law—not the law of the state of incorporation. For example, in *Galbreath v. Scott*,[15] the Alabama Supreme Court applied Alabama law to a dispute between shareholders of a Florida corporation without any discussion of choice of law issues. The likely explanation is that the parties failed to seek the application of foreign law.[16]

In a recent decision, *Ex parte Bentley*,[17] the Alabama Supreme Court affirmed its recognition of the Internal Affairs Doctrine. The plaintiffs in the underlying action, Cobalt BSI Holding, LLC ("Cobalt"), a Delaware limited liability company based in Nevada, and Intergraph Corporation ("Intergraph"), a Delaware corporation based in Alabama, sued Bentley Systems Incorporated ("BSI"), a Delaware corporation based in Pennsylvania, and Gregory S. Bentley, Keith A. Bentley, Barry J. Bentley, Raymond B. Bentley, and Richard P. "Scott" Bentley ("the Bentley brothers"), residents of Pennsylvania, in Madison County Circuit Court, both directly and derivatively as shareholders of BSI.[18]

The action challenged an incentive-compensation plan, alleged that the Bentley brothers were operating BSI as their corporate alter ego and requested removal of the Bentley brothers from any managerial or directorial position at BSI.[19] The defendants filed a motion to dismiss, asserting that (1) Delaware was a more appropriate forum for the lawsuit under the doctrine of *forum non conveniens*, (2) an Alabama court may not interfere with the internal affairs of a Delaware corporation and (3) the court lacked personal jurisdiction over the

Bentley brothers.[20] The trial court denied the motion to dismiss, and defendants filed a petition for writ of mandamus arguing that the case should be dismissed for the same three reasons.[21] The Alabama Supreme Court denied the petition holding that (1) BSI was not entitled to dismissal on *forum non conveniens* grounds,[22] (2) the Internal Affairs Doctrine did not deprive the court of jurisdiction over defendants and (3) Alabama courts had personal jurisdiction[23] over the Bentley brothers.[24]

In deciding the issue of personal jurisdiction, the Alabama Supreme Court engaged in an in-depth discussion of the Internal Affairs Doctrine. The court defined the Internal Affairs Doctrine as "[t]he long-recognized principle that '[t]he courts of one state have no visitorial power over the corporations of another state in matters of vital concern to internal policy and management....'"[25]

In *Bentley*, the Alabama Supreme Court quoted extensively from the United States Bankruptcy Court for the Northern District of Alabama's opinion *In re Chalk Line Manufacturing, Inc.*[26] and described Judge James S. Sledge's opinion as "[a] scholarly discussion of the state of Alabama law concerning the internal-affairs doctrine in an analogous factual context."[27] In *Chalk Line*, the Bankruptcy Court was charged with deciding whether a shareholder or group of shareholders in a Delaware corporation could pursue an action in an Alabama court against other shareholders for breach of fiduciary duty, breach of duty to disclose and minority shareholder oppression.[28] In determining whether the shareholders could pursue the action in Alabama, the Bankruptcy Court had to decide (1) which state's law applied and (2) whether the state's law that did apply recognized the causes of action asserted in the complaint.[29] The Bankruptcy Court ultimately upheld Alabama's long standing law that the Internal Affairs Doctrine required the application of Delaware law with regards to the claims.[30]

As the Delaware Supreme Court did in *VantagePoint*, the Bankruptcy Court set forth three reasons why it should apply the corporate law of the state of incorporation in *Chalk Line*. First, it cited Alabama case law affirming the long-standing choice of law principle that "[t]he law of the state of incorporation governs the internal corporate relationship."[31] In fact, the Bankruptcy Court looked to Delaware law regarding the scope of the Internal Affairs Doctrine, citing the case of *McDermott Inc. v. Lewis*, in which the Delaware Supreme Court held that the Internal Affairs Doctrine governed choice-of-law determinations involving "[t]hose activities concerning the relationships *inter se* of the corporation, its directors, officers and shareholders."[32] Second, the Bankruptcy Court also recognized important public policy concerns in determining which state's law should govern. Specifically, it cited the following analysis of the policy behind the Internal Affairs Doctrine:

> [A]pplying local internal affairs law to a foreign corporation just because it is amenable to process in the forum or because it has some local shareholders or some other local contact is apt to produce inequalities, intolerable confusion, and uncertainty, and intrude into the domain of other states that have a superior claim to regulate the same subject matter.[33]

Third, the Bankruptcy Court also held in *Chalk Line* that application of the Internal Affairs Doctrine is required under the Due Process Clause, the Commerce Clause and Full Faith and Credit Clause of the U.S. Constitution. Adopting the Delaware Supreme Court's analysis in *McDermott*, the Bankruptcy Court held:

> Under the commerce clause *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), determined that a state may regulate interstate commerce indirectly, but emphasized that the burden placed upon interstate commerce may not be excessive in relation to the local interests served by the regulation. In *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), the Supreme Court ruled that under the commerce clause, a state "has no interest in regulating the internal affairs of foreign corporations." *Id.* at 645-646. If that is so, then a court or state which attempts to displace the internal affairs doctrine carries a heavy burden to justify its actions.[34]

The Bankruptcy Court also noted that the United States Supreme Court's recent decision in *CTS Corp. v. Dynamics Corp.*

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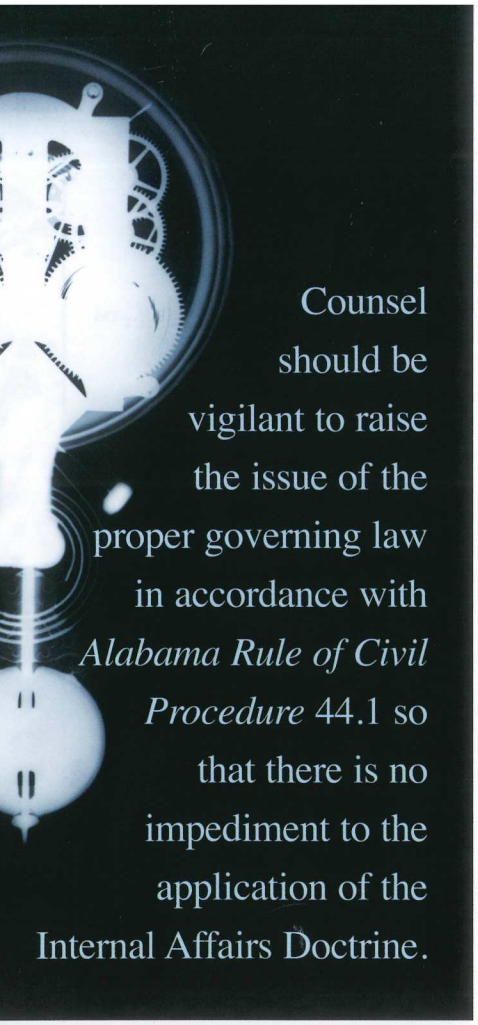


of America, 481 U.S. 69 (1987) offers additional support:

> No principal [sic] of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders ... This beneficial free market system depends at its core upon the fact that a corporation - except in the rarest situations - is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the state of its incorporation.[35]

The Bankruptcy Court's scholarly opinion in *Chalk Line*, much like *Vantage Point*, provides three reasons that the Internal Affairs Doctrine should be uniformly enforced—state law, public policy and constitutional concerns. Although the Alabama Supreme Court in *Bentley* was only faced with the issue of whether an Alabama court had personal jurisdiction and, thus, found it unnecessary to adopt the entire rationale of *Chalk Line*, it did note its approval of the *Chalk Line* decision.[36]

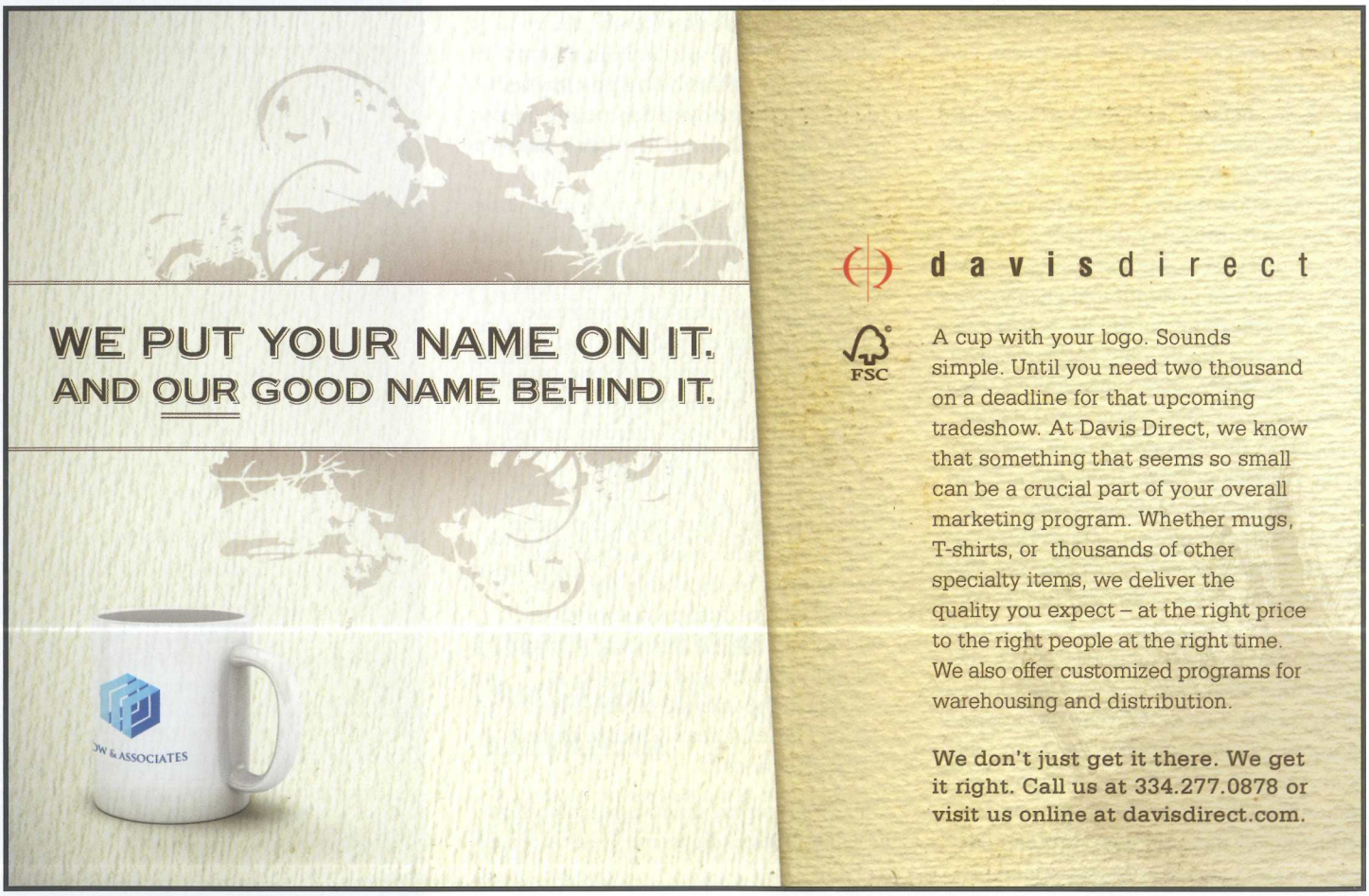
Thus, the Alabama Supreme Court, through its approval of the Bankruptcy Court's opinion in *Chalk Line*, reaffirmed the vitality of the Internal Affairs Doctrine in Alabama and provided a roadmap to parties involved in such business disputes.

Conclusion

Alabama courts have strictly adhered to the Internal Affairs Doctrine when determining issues related to corporate governance. *Bentley* and *Chalk Line* provide a roadmap for the application of the Internal Affairs Doctrine in any case involving claims relating to the internal affairs of a business. Counsel should be vigilant to raise the issue of the proper governing law in accordance with *Alabama Rule of Civil Procedure* 44.1 so that there is no impediment to the application of the Internal Affairs Doctrine. ▲▼▲

Endnotes

1. No. 1081083, 2010 WL 2034943 (Ala. May 21, 2010).
2. Matt Stevens, *Internal Affairs Doctrine: California v. Delaware in a Fight for the Right to Regulate Foreign Corporations*, 48 B.C. L. Rev. 1047 (2007).



3. *Ellis v. Mutual Life Ins. Co.*, 187 So. 434, 443 (Ala. 1939) (citations omitted).

4. *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 621 (1983) (holding that application of the law of the state of incorporation "[a]chieves the need for certainty and predictability of result while generally protecting the justified expectations of parties with interests in the corporation." (*citing* Restatement (Second) of Conflict of Laws § 302, comments a and e (1971)).

5. *The Internal Affairs Doctrine: Theoretical Justifications and Tentative Explanations For Its Continued Primacy*, 115 Harv. L. Rev. 1480 (2002). California is the notable exception as it enacted a statute that regulates the internal affairs of foreign corporations if: (1) more than one-half of its property assets, sales revenue and payroll expenses are located in California and (2) more than one-half of its voting securities are held by people with California addresses of record. Cal. Corp. Code § 2115(a).

6. 871 A.2d 1108, 1113 (Del. 2005) (holding that "it is now well established that only the law of the state of incorporation governs and determines issues relating to a corporation's internal affairs.").

7. *Id.* at 1112 (*citing McDermott, Inc. v. Lewis*, 531 A.2d 206, 215 (Del. 1987)); *see also Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982).

8. *Id.* at 1112-1113.

9. *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 91 (1987)

10. 871 A.2d at 1113 (*quoting McDermott*, 531 A.2d at 216-217) (*quoting in turn Edgar*, 457 U.S. at 645-646).

11. *Id.* (*quoting McDermott*, 531 A.2d at 216-217 (*quoting in turn CTS*, 481 U.S. at 90)).

12. *See Boyette v. Preston Motors Corp.*, 89 So. 746 (Ala. 1921).

13. 601 So. 2d 449, 454 (Ala. 1992) (citations and internal quotation marks omitted).

14. *Ala. Code* § 10-2B-15.05. *See also* Ala. Code § 10-8A-1009 ("[i]t is the policy of this state that the internal affairs of foreign registered limited liability partnerships, including the liability of partners for debts, obligations and liabilities of, or chargeable to, the partnership or another partner or partners, shall be subject to and governed by the laws of the jurisdiction in which such foreign registered limited liability partnership was formed."); *Ala. Code* § 10-12-46 ("[t]he laws of the state or other jurisdictions under which a foreign limited liability company is organized govern its organization, its internal affairs, and the liability of its members.").

15. 433 So. 2d 454 (Ala. 1983).

16. The controlling procedural rule relating to timing of raising a choice-of-law issue is *Alabama Rule of Civil Procedure* 44.1, which provides:

    A party who intends to raise an issue concerning the law of another state or of any territory or dependency of the United States or of a foreign country shall give notice by pleadings or other reasonable written notice. The court, in determining such law, may consider any relevant material or source, including testimony, whether or not submitted by a party or admissible under the *Alabama Rules of Evidence*. The court's determination shall be treated as a ruling on a question of law.

    Ala. R. Civ. P. 44.1.

17. 2010 WL 2034943 (Ala. May 21, 2010).

18. *Id.* at *1.

19. *Id.*

20. *Id.* at *3.

21. *Id.*

22. The court held that BSI was not entitled to dismissal of the action on *forum non conveniens* grounds when BSI maintained an office in Alabama that employed over 120 people, more than 130 shareholders lived in Alabama, BSI held board meetings and distributed financial statements in Alabama, and there was no evidence that any of the acts that gave rise to the dispute occurred in another state. *See id.* at *4-5.

23. The court held that it had personal jurisdiction over the Bentley brothers when they had "[s]ent many thousands of written and electronic communications to Alabama in furtherance of their interests in BSI; [had] made numerous telephone calls to and participated in telephone conferences in this State; and [. . .] ha[d] traveled to this State on many occasions." *See id.* at *11. Furthermore, the court looked to the fact that the Bentley brothers had been involved in prior litigation concerning BSI in Alabama and that BSI's second largest office was located in Alabama. *See id.*

24. *See id.* at *4-12.

25. *Id.* at *6 (*citing Ellis v. Mutual Life Ins. Co. of New York*, 187 So. 434, 444 (Ala. 1939) (*quoting Hoglan v. Moore*, 122 So. 824, 828 (Ala. 1929))).

26. No. 93-42773(11), 1994 WL 394978 (Bkrtcy. N.D. Ala. 1994).

27. 2010 WL 2034943, at *6.

28. 1994 WL 394978, at * 2.

29. *Id.*

30. *Id.* at *7.

31. *Id.* at *2 (citations omitted).

32. *Id.* (*citing* 531 A.2d 206, 214 (Del. 1987)).

33. *Id.* at *7 (*citing* P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 Duke L.J. 1, 98 (as cited in *McDermott*, 531 A.2d at 216)).

34. *Id.* at *6.

35. *Id.* at *6 (*quoting* 481 U.S. at 88).

36. 2010 WL 2034943, at *10.

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BP Filing Deadline

The vast majority of lawsuits filed against BP, and the other entities involved in the Deepwater Horizon incident and resulting oil spill, have been consolidated in a proceeding in federal court in Louisiana. If persons and entities having claims against these parties have not asserted their claims by April 20, 2011, some or all of their claims may be forever barred. Filing a claim with the Gulf Coast Claims Facility (Feinberg's process) does not constitute filing a claim in this court action.

The *U.S. District Court, Eastern District of Louisiana,* has allowed the joinder in the action (the filing of a claim) via a short form.

The deadline to file claims in the BP lawsuit pending as an MDL is April 20, 2011.