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# Federal Courts: Jurisdiction over Foreign Corporations--A Question of Federal or State Law

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## Recent Decisions

### FEDERAL COURTS: JURISDICTION OVER FOREIGN CORPORATIONS — A QUESTION OF FEDERAL OR STATE LAW

*Arrowsmith v. United Press Int'l*, 320 F.2d 219 (2d Cir. 1963).

A resident of Maryland brought a diversity action for libel in the Federal District Court of Vermont against a New York corporation.<sup>1</sup> The district court dismissed the complaint on the ground that no right to relief had been shown.<sup>2</sup> On appeal, the Second Circuit sitting *en banc*, vacated the district court's decision and remanded the case for consideration of the issue of jurisdiction over the defendant corporation. Held: (1) state law determines whether the federal court may assume personal jurisdiction over a foreign corporation in a diversity action,<sup>3</sup> and (2) federal law is invoked only to determine the constitutionality of the state's assertion of jurisdiction.

The majority opinion expressly overrules the alternative holding of a previous Second Circuit decision, *Jaftex Corp. v. Randolph Mills, Inc.*<sup>4</sup> Judge Clark, who had written the majority decision in *Jaftex* strongly dissented, contending that federal law alone governs this jurisdictional question.

Diversity jurisdiction affords an out-of-state litigant a neutral forum.<sup>5</sup> But this jurisdiction is sharply limited by the application of state law and state policy as demanded by *Erie R.R. v. Tompkins*.<sup>6</sup> Oftentimes state policy conflicts with the procedure and independent administration of the federal courts.<sup>7</sup> Specifically, a conflict exists when a state has not gone as far as the Constitution permits in holding a foreign corporation amenable to suit.<sup>8</sup> Under these circumstances a federal court in a diver-

1. The action was brought in Vermont apparently to take advantage of that state's three year statute of limitations for libel actions. According to the majority opinion only three other states, Arkansas, New Mexico, and Hawaii, have such lengthy periods of limitation. *Arrowsmith v. United Press Int'l*, 320 F.2d 219, 221 & n. 2 (2d Cir. 1963).

2. *Arrowsmith v. United Press Int'l*, 205 F. Supp. 56 (D. Vt. 1962).

3. Since the instant case did not require the court to pass on the issue of the applicable "doing business" standard, the elaborate opinion may be characterized as dictum. But dictum or not, no one can now doubt the Second Circuit's position on this issue.

4. 282 F.2d 508 (2d Cir. 1960).

5. Diversity jurisdiction has withstood many attacks over its 175 year history. See generally 1 MOORE, FEDERAL PRACTICE ¶ 0.60 [8.-4] (2d ed. 1961).

6. 304 U.S. 64 (1938).

7. See *Ragan v. Merchant Transfer & Warehouse Co.*, 337 U.S. 530 (1949) wherein a state provision concerning commencement of actions was held controlling over the Federal Rules. See also *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949) wherein it was held that a local statute which under certain circumstances requires a plaintiff to give security for the payment of reasonable expenses cannot be disregarded by federal courts in diversity actions.

8. *Perkins v. Benguet Consol. Mining Co.*, 342 U.S. 437, *on remand*, 158 Ohio St. 145, 107

sity action is faced with the crucial question: shall it apply the state "doing business" test or the federal standard?<sup>9</sup> Application of the broader federal standard may allow the plaintiff a suit in a federal court which is denied him by the state court. On the other hand, application of the narrower state standard by the federal court results in the surrender of that court's right to determine the parties over whom it will adjudicate. It is a close question. The courts and commentators are divided.<sup>10</sup>

The approach to this problem has not been universal. Moreover, different approaches have been employed in reaching the same conclusion. As a result, classification of the various federal courts according to their application of a federal or state test is of little benefit in evaluating the principal issue.<sup>11</sup> Some courts appear oblivious to any *Erie*

N.E.2d 203 (1952); *Wescott-Alexander, Inc. v. Dailey*, 264 F.2d 853 (4th Cir. 1959); *Elliott v. United States Steel Export Co.*, 186 F. Supp. 57 (E.D. Pa. 1960).

9. The "federal standard" for determining personal jurisdiction over a foreign corporation escapes exact definition. Courts generally rely on notions of fairness and reasonableness in the application of tests which vary with the individual case. Moreover, the extent of the federal standard is unclear. Many federal courts apply identical standards in defining both the due process limits of state jurisdiction and the extent of federal jurisdiction. See, e.g., *Sanders Associates, Inc. v. Galion Iron Works & Mfg. Co.*, 304 F.2d 915 (1st Cir. 1962); 14 W. RES. L. REV. 610 (1963).

Removal jurisdiction is not involved. All courts appear to agree that the state "doing business" standard is applicable upon removal to the federal court. See, e.g., *Rosenthal v. Frankfort Distillers Corp.*, 193 F.2d 137 (5th Cir. 1951); *Pucci v. Blatz Brewing Co.*, 127 F. Supp. 747 (W.D. Mo. 1955).

10. Compare 1A MOORE, FEDERAL PRACTICE § 0.317(5), at 3535 (2d ed. 1951) (federal standard applies), with 1 BARRON & HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE § 138 n.35.4, at 601 (Rules ed. 1960) (state standard applies).

11. According to the *Arrowsmith* majority opinion, there "exists an overwhelming consensus that the amenability of a foreign corporation to suit in a federal court in a diversity action is determined in accordance with the law of the state where the court sits . . ." *Arrowsmith v. United Press Int'l*, 320 F.2d 219, 223 (2d Cir. 1963). Cases are cited from Circuits 1, 3, 4, 5, 7, 8, 9, and 10 as applying a state standard. Judge Clark, in an appendix, attempts to cut down this authority to the Third and Seventh Circuits. He contends that cases in which service was made under rule 4(d) (7) of the Federal Rules are not in point. In these cases, "state law must of course be looked to in determining whether a defendant served pursuant to a state statute is properly before the court." *Id.* at 242.

The majority finds this position "quite unsound." Although a defendant is served pursuant to Rule 4(d) (7), the initial issue before the court is one of jurisdiction over the person and not manner of service.

The majority has the better reasoned view. Even though service is made on a state official as required by state statute, the federal court must first consider whether the defendant corporation is amenable to suit before it examines the validity of that service in other respects. Prior to deciding the initial issue of jurisdiction, the court must determine which standard it will apply — state or federal.

A careful reading of the cases cited by the majority, however, reveals that the foregoing analysis is rarely followed. As pointed out by Judge Biggs, concurring in *Partin v. Michaels Art Bronze Co.*, 202 F.2d 541 (3d Cir. 1953), a leading case for the majority position, "it is not apparent whether the decision (in *Partin*) is based on a construction of Fed. Rules Civ. Proc., rule 4(d) (7) . . . or strictly on the doctrine of *Erie R. Co. v. Tompkins*." *Id.* at 545.

In spite of the paucity of decisions which fully consider the problem and the resultant confusion in this area, it generally is agreed that the greater weight of authority favors the application of state law. For listings of cases under various classifications see *Kenny v. Alaska Airlines, Inc.*, 132 F. Supp. 838, 845-46 nn.7-9 (S.D. Cal. 1955); 1 BARRON & HOLTZOFF,

implications,<sup>12</sup> others specifically find *Erie* inapplicable,<sup>13</sup> while still others deem *Erie* not only in point, but controlling.<sup>14</sup>

Several courts have ignored *Erie* by resting their application of a state standard on rule 4(d)(7) of the Federal Rules of Civil Procedure.<sup>15</sup> This rule provides that service of process is sufficient if made in the manner prescribed by the forum state.<sup>16</sup> It has been interpreted as a demand that state law determine the question of jurisdiction over foreign corporations. This view has no basis. Rule 4(d)(7) merely provides an alternate method for service and no jurisdictional meaning may be attached.<sup>17</sup>

Other courts ignoring *Erie* have applied the federal standard. These courts simply fail to recognize the existence of a jurisdictional issue.<sup>18</sup> Authority for the applicable "doing business" test is grounded indiscriminately on both pre- and post-*Erie* decisions. The great majority of cases applying the federal standard fall into this category.

In a second approach to this issue, courts have appreciated the importance of the *Erie* decision, but regard its doctrine as inapplicable to the question of personal jurisdiction. Shortly after *Erie*, an Ohio district court reasoned that the issue of jurisdiction over a foreign corporation is simply a procedural matter.<sup>19</sup> Thus, the federal and not the Ohio "doing business" test was applied.

A more compelling argument for the inapplicability of *Erie* takes into account the outcome test<sup>20</sup> defined in *Guaranty-Trust Co. v. York*.<sup>21</sup> It is contended that the outcome test does not extend to the initial amenability to suit, but is only applied *after* jurisdiction is established. According to this restricted view, the application of state law *after* disposal of the jurisdictional issue necessarily results in uniformity of outcome.

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FEDERAL PRACTICE AND PROCEDURE, § 179 nn. 95.3, 96, at 696-97 (Rules ed. 1960); Note, *Doing Business as a Test of Venue and Jurisdiction Over Foreign Corporations in the Federal Courts*, 56 COLUM. L. REV. 394, 398 n.27 (1956).

12. See, e.g., *L.D. Reeder Contractors v. Higgins Indus., Inc.*, 265 F.2d 768 (9th Cir. 1959).

13. See, e.g., *Hedrick v. Canadian Pac. Ry.*, 28 F. Supp. 257 (S.D. Ohio 1939).

14. See, e.g., *Kenny v. Alaska Airlines, Inc.*, 132 F. Supp. 838 (S.D. Cal. 1955).

15. *Illiff v. American Fire Apparatus Co.*, 277 F.2d 360 (4th Cir. 1960); *Florio v. Powder Power Tool Corp.*, 248 F.2d 367 (3d Cir. 1957).

16. Service "is also sufficient if the summons and complaint are served in the manner prescribed . . . by the law of the state in which the district court is held . . ." FED. R. CIV. P. 4(d)(7).

17. Rule 82 of the Federal Rules of Civil Procedure specifically states that venue and jurisdiction are unaffected by the rules. Thus, any argument based on the wording of rule 4(d)(7) alone is clearly erroneous.

18. See, e.g., *Lasky v. Norfolk & W. Ry.*, 157 F.2d 674 (6th Cir. 1946); *McWhorter v. Anchor Serum Co.*, 72 F. Supp. 437 (W.D. Ark. 1947).

19. *Hedrick v. Canadian Pac. Ry.*, 28 F. Supp. 257 (S.D. Ohio 1939).

20. In diversity cases, the outcome of the litigation in the federal court should be substantially the same as it would be if tried by a state court.

21. 326 U.S. 99 (1945).

This view ignores the fact that the Supreme Court already has limited the jurisdiction of the federal courts in diversity actions by demanding enforcement of state door-closing statutes.<sup>22</sup> As a result of these decisions, a foreign corporation which is barred from the use of a state's courts is not allowed recourse to the federal courts on the basis of diversity. Thus, the Supreme Court has already extended the *Erie—Guaranty* analysis to the initial amenability to suit. Therefore, application of the outcome test to the principal issue demands there be *no outcome* in the federal court since the state's refusal to take jurisdiction results in no outcome in the state court. Only then does there exist true intra-state uniformity.<sup>23</sup>

A third approach to the instant question involves application of the *Erie—Guaranty* analysis as modified in *Byrd v. Blue Ridge Rural Elec. Co-op., Inc.*<sup>24</sup> This case suggests an interest-weighting test for determination of the applicable standard in the individual diversity case. The policy of providing the same outcome in the federal court as in the state court must be balanced against federal policies demanding independent administration of the federal courts. In *Byrd*, the overriding federal policy requiring jury trial was "under the influence — if not the command — of the Seventh Amendment. . . ."<sup>25</sup> In the instant case Judge Clark, in dissent, finds an overriding federal policy within Article III of the Constitution which demands that the federal courts hear diversity cases.<sup>26</sup> Judge Clark cites *Monarch Ins. Co. v. Spach*<sup>27</sup> for a statement of what he considered to be the correct rule: "In entertaining diversity cases . . . [the federal district court] is responding to a constitutional demand made effective by congressional action and . . . has a constitutional duty to hear and adjudicate."<sup>28</sup> In sum, the federal courts are an independent system and therefore should remain sovereign on the issue of admittance to their courts.

Furthermore, the Court in *Byrd*, prior to invoking the interest weighing test, interpreted the state rule as one not bound up with the state created right. Arguing analogously it has been maintained that restrictive state service of process laws are not indicative of state policy, but are

22. *Woods v. Interstate Realty Co.*, 337 U.S. 535 (1949), wherein the door was closed to plaintiffs who had not complied with the prerequisites demanded by a state statute for maintenance of suit; *Angel v. Bullington*, 330 U.S. 183 (1947), wherein the door was closed by a state statute to a mortgagee seeking a deficiency judgment.

23. See generally Note, 37 IND. L.J. 352, 354-55 (1962).

24. 356 U.S. 525 (1958).

25. *Id.* at 537.

26. "The judicial Power shall extend to . . . Controversies . . . between Citizens of different States. . . ." U.S. CONST. art III, § 2.

27. 281 F.2d 401 (5th Cir. 1960).

28. *Id.* at 407.