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Chapter 6

Fundamental Changes in Marketable Share Companies

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Chapter 6

FUNDAMENTAL CHANGES
IN MARKETABLE
SHARE COMPANIES

Alfred F. Conard

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Chapter 6

FUNDAMENTAL CHANGES
IN MARKETABLE
SHARE COMPANIES

Alfred F. Conard

I. INTRODUCTION*

1. *Change and continuity.* – Change is a law of life in business associations as in other living organisms. The circumstances which have overtaken world-famous companies – like the Union Minière du Haut-Katanga, the Compagnie Universelle du Canal Maritime de Suez, and the Société Impériale Ottomane du Chemin de Fer de Baghdad – have their parallels in less conspicuous catastrophies which befell countless independent retail stores, cotton textile mills, coal mines, and harness manufacturers. In addition to companies like these – victims of radical changes in their environments – there were even more numerous victims of their own misperceptions of existing conditions – overestimated demand for products, underestimated costs, and miscalculated processes. All of these circumstances called for change in the activities, policies, financing or structures of the companies involved.

In general, the company laws of the nineteenth century made inadequate provisions for change – either for enormous successes requiring a great expansion of capital and scope or operations, or for failures requiring radical departures from original plans. The era's most prevalent concession to needs of reassessment was a limitation of the lives of companies to a fixed period of 20 or 30 years, at the end of which they were expected to dismember themselves and let the investors form new plans for the new times. But if the future had been unwisely predicted, the time for reconsideration was usually far less than the life of the company; and if the decision had been wise, a dissolution at the appointed time was a tragedy for investors, workers and consumers.

There was a need not only for change but also for continuity. The high costs of assembling money, facilities, management and manpower did not need to be completely sacrificed whenever a company was obliged to restructure one item in the complex. Many factors in the combination could be salvaged if the enterprise were allowed to change its purpose, its capitalization, or its facilities without abandoning all the rest. There

is a need for change without dissolving the whole aggregation of rights and duties known as the corporate entity, or the juridical person.

2. *The legal formats of change.* – *Documentary alterations.* – Much of the change that takes place in business associations is continuous and imperceptible, like the changes in the merchandise which evolve as old goods are sold, and different goods are bought or manufactured to replace them. The financial structure also changes, as additional shares of stock are sold, and as new loans are made or old ones repaid. As economic changes accumulate, it becomes necessary to make *documentary alterations* in the charter or internal regulations in order to permit the economic changes, or to legalize them if they have already occurred (*infra* s. 5–29). If the intended alterations would violate the rules of law under which the company operates, it may need to become a new kind of company, by the process of “transformation” (*infra* s. 33–35). If the relationship to be changed is one involving creditors, the adaptation must be made in the bond indentures or other documents which govern these relationships (*infra* s. 36–44).

Changes in assets or control. – Another group of changes consist primarily in fundamental changes in the ownership of assets, to which changes in the documents are incidental if necessary at all. A clear example is the transfer of assets from one company to another, which has received very different legal treatment in the selling and the buying companies (*infra* s. 45–62). The replication of this process had led to recognizing special categories of asset transfer which have a character of their own, known by a host of names including fusion, merger, consolidation, amalgamation, and scission (*infra* s. 70–91).

The most recent to attract legal attention, among transactions of this sort, is the transfer of control of a company. Only a few countries have recognized any need for special regulation of this phenomenon – led by ENGLAND in relation to “take-over bids” (*infra* s. 63–69) and by GERMANY

* This chapter undertakes to present the state of the law generally as of 1 January 1968. Some changes made during 1968 and 1969 are reflected, but not necessarily all such changes.

The author gratefully acknowledges his debt to Professors L. C. B. Gower (London), Roger Houin (Paris), Knut Rodhe (Stockholm) and Hans Würdinger (Hamburg), each of whom made an invaluable critique

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with regard to "enterprise contracts" (*infra* ch. 7).

Termination. – Provisions for the ending of company activities, through processes known as "dissolution," "liquidation," and "winding up," have long been familiar to the law, but they have taken on new significance in recent years. Originally they were conceived as instruments of the grim reaper, arriving inevitably through misfortune or the flux of time. Today, dissolution may also be an instrument of policy; sometimes the controlling shareholders dissolve "voluntarily" – usually as a part of a plan for transferring assets; sometimes a minority of shareholders seeks dissolution as a weapon of defense or counter-offensive against an oppressive majority; and sometimes dissolution is a weapon of the state, seeking to punish violations of public policy, or neglect of duties to pay taxes (*infra* s. 92–102).

Changes in capital. – Increases and decreases of capital involve fundamental changes which receive more or less legal regulation in a variety of countries. They are not treated in this chapter, although logically within its scope, because it has seemed more useful to discuss them in connection with other provisions for the maintenance of capital, in an earlier chapter (*supra* ch. 5).

Unregulated fundamental changes. – Since this is a study of law, not of economics, we write only of those fundamental changes to which some special legal controls have been attached. But a realistic view of modern company life forces us to recognize that some very fundamental changes have escaped legislative attention. In fact, company lawyers are often astute at devising means for permitting companies to make great changes with a minimum of legal formality.

Examples include the listing of the company's shares on a stock exchange, which suddenly exposes the shareholders' interests to a heightened degree of speculation, and frequently triggers a number of rules of law. Under the current UNITED STATES law, the company and its shareholders enter into a new regime merely by the increase of the entries on the shareholders' register from 499 to 500, coupled with a growth of assets from \$999,999 to \$1,000,000 (*infra* ch. 10).

Fundamental changes may also take place through relationships between companies – the acquisition of controlling shares, or the entry into an agreement for common management. These sorts of changes incur special regulation under the new GERMAN laws on company systems, and under UNITED STATES laws on certain types of public utilities, but generally escape regulation elsewhere (*infra* ch. 7).

3. *Regulation of change.* – *Shareholders' assent.* – As legislators have grudgingly opened the doors

of change, they have erected impressive obstacles to any impetuous stampede. With remarkable harmony, most countries concur in demanding that shareholders must approve by some especially difficult measure, such as a majority counted among all eligible shares, a supermajority of two-thirds or three-fourths, a specified quorum, negation of plural voting, or some combination of these (*infra* s. 21). There is an evident distrust of impetuous movements. An overwhelming voice is required for change, although a very small voice, or simple non-participation, may suffice to keep things as they are.

All of these precautions are imposed, presumably, in fidelity to the principle of "shareholder democracy," which likens the shareholders in a company to the citizens of a republic. Like most other expressions of this principle in company law, it seems to be successfully manipulated by the managers of enterprises, who get their way equally well, regardless of the formal requirements.

It is hardly surprising that the managers get their way, since many of the laws make only perfunctory requirements to tell the shareholders what the voting is about (*infra* s. 24, 49, 80). These requirements have been stiffening in recent years. But it cannot be said even in the UNITED STATES, where proxy statement standards are most exacting, that shareholders usually make an enlightened choice.

Assent of bondholders and others. – EUROPEAN laws sometimes require not only the assent of shareholders, but also of bondholders, and holders of other kinds of securities such as founders' shares (*infra* s. 26–28, 54, 82, 90). Here is an unusually sharp contrast between the requirement of legal systems which otherwise move on nearly parallel tracks. In spite of extensive investigation and reform regarding bondholders' rights in the UNITED STATES, it does not seem to have occurred to the critics that a democratic voice was an answer to the bondholders' problems. Neither do the EUROPEAN commentators have much to say about the effectiveness of the rules on bondholders' assent.

Approval by courts or commissions. – In the middle of the twentieth century, the trend in regulation of companies seems to be toward the intervention of courts and commissions. This tendency is visible in the area of fundamental changes, although less conspicuously than in the matter of public offerings of securities for sale. Reorganizations and reconstructions of various sorts are systematically subjected to court or commission control. Courts are gradually accepting increased responsibility for determining the fairness as well as the formal rectitude of changes.

A few countries, led by ENGLAND, have even authorized the court to make an affirmative order for an amendment, to correct a fraudulent or oppressive management (*infra* s. 28).

4. *Rights of dissenters.* – As the power of majorities to make changes has expanded, minorities have had an increasing need for some sort of protection. The procedural requirements of quorums and supermajorities have proved to be nearly valueless, and the rights to information in proxy statements have not been much better. The right to appeal to a court or commission to determine the fairness of a proposed change is a potentially effective arm, but slow and expensive,

and effective only against rather egregious oppression (*infra* s. 104–105).

A most hopeful new right has appeared on the twentieth century scene in the form of a right to withdraw one's investment at an impartial valuation. This is granted very widely in the contemporary legislation of ARGENTINA, ITALY, and the UNITED STATES, and is supplied at the points of greatest stress in ENGLAND and GERMANY. It seems to be growing in influence, but there is still a long way to go in the establishment of economical and efficient means of evaluating the shares that are withdrawn (*infra* s. 106–111).

II. AMENDMENT OF CHARTERS AND INTERNAL REGULATIONS

A. THE CONCEPT OF AMENDMENT

5. *Content of the concept.* – An “amendment” of a charter or of internal regulations is a corporate action which changes the express terms of the standing rules under which the company operates. Typical examples are a change of name, an addition of a new purpose, a change in the rights of various classes of shareholders, an extension of the duration of the company, an alteration of the voting rules, or an increase or decrease in capital. It corresponds in general to the ENGLISH “alteration” of the memorandum or articles, the FRENCH *modification des statuts*, the GERMAN *Satzungsänderung*, the ITALIAN *modificazione dell’atto costitutivo*, the MEXICAN *modificación del contrato social*, and the CHILEAN and VENEZUELAN *reforma de los estatutos*. But some of these terms are wider in scope than the AMERICAN “amendment of charter”; they have been used to embrace virtually all varieties of fundamental change. An example is the MEXICAN law, which provides for extension of duration, voluntary dissolution, increase or decrease of capital, change of purpose or nationality, transformation, fusion, and “any other [*sic*] amendment of the charter.”¹ In FRENCH law, where the former statute made no express provisions for fusion, commentators regarded fusion as a species of amendment.² In GERMAN law, the question was formerly mooted whether “enterprise contracts” should be regarded as amendments, until a statute settled the question by providing a separate rule for them.³

This subchapter will deal with charter amendment in a narrower sense; it will exclude several important types of fundamental change which have acquired an identity of their own – trans-

formation, modification of creditors’ rights, sale of assets, takeover, fusion, scission and termination. Each of these is the subject of a separate subchapter.

6. *What is amended: two kinds of basic documents.* – The basic documents of companies in various countries differ at least as widely as their ways of eating. Some countries have two breakfasts while others have one; some have tea and dinner, while others just eat supper. Similarly, some have two documents which contain the governing rules of the particular company, while others have only one.⁴

FRANCE, ITALY, JAPAN and various SPANISH-speaking countries furnish examples of the simpler practice, with a single document – the FRENCH *statuts*, the ITALIAN *atto costitutivo*, or the SPANISH *estatutos*. If the shareholders or governing boards choose to adopt additional standing orders or standard operating procedures – as they may well do – these are not required, nor expressly contemplated, by statute. WEST GERMANY differs only a little, in that the 1965 law for the first time expressly permits internal regulations (*Geschäftsordnung*), without requiring them, or specifying anything that they ought to contain (AktG §77 par. 2).

A more complex practice, which prevails in ENGLAND and the UNITED STATES, requires at least two documents,⁵ of which the first is usually called the memorandum of association, certificate of incorporation, or articles of incorporation,⁶ and the second is called articles of association or bylaws.⁷ The second document is not formally required in some situations, but is expressly contemplated by legislation, and is universally employed in well-run companies.⁸ The second

¹ MEXICO: Ley gen. art. 182 (XI); cf. VENEZUELA: Comm. Cart. 280.

² *Rodière and Houin* I no. 516.

³ *Würdinger* 169; AktG § 293.

⁴ See ch. 3 for a general discussion of the constitutive documents of marketable share companies.

⁵ MASSACHUSETTS, which revels in associational idiosyncrasy, calls for three legislative documents – the agreement of association, the articles of organization, and the bylaws: Mass. G.C.L. § 6, 10, 13.

⁶ ENGLAND and the BRITISH COMMONWEALTH nations generally use “memorandum of association”: CA s. 1–2; AUSTRALIA: Companies Act 1961, s. 16(1); CANADA: Companies Act 1952, s. 7(2). In the UNITED STATES, the states of DELAWARE, NEW YORK and some others use “certificate of incorporation”: Del. G.C.L. § 102;

N.Y.B.C.L. § 402–403. CALIFORNIA, the Model Act and some others use “articles of incorporation”: Cal. G.C.L. § 301; Model B.C.A. § 53–54.

⁷ ENGLAND and AUSTRALIA use “articles of association”: CA s. 5–6 and AUSTRALIAN Companies Act s. 16(1). CANADA and US states use “bylaws”. *Neuman*, Letters Patent and Memorandum of Association Companies: *Ziegel* 61–101, 84; Cal.G.C.L. § 500–501; Del.G.C.L. § 109; N.Y.B.C.L. § 601; Model B.C.A. § 27.

⁸ For ENGLAND, see *Pennington* 14, *Gower* 245. Articles are compulsory for unlimited companies and for companies limited by guarantee; a company limited by shares (the most common kind) is not required to adopt articles, but if it does not, a set of internal regulations prescribed by statutes is automatically im-

document must be publicly recorded in ENGLAND,⁹ but it is in the UNITED STATES a private document which even the shareholders may have difficulty in seeing (although their legal right to do so is unquestioned).¹⁰ Additional characteristics of the second document are stated *infra* s. 30.

In order to simplify reference to these many-titled documents, the term "memorandum" or "charter" will be applied to the single formative document in countries following the FRENCH and GERMAN patterns, and to the more basic document in ENGLAND and the UNITED STATES. The secondary document – the ENGLISH "articles of association" and AMERICAN "bylaws" – will be characterized as "internal regulations". The latter term will also include any second document of company rules which may be found to exist in NON-ENGLISH speaking countries.

It is difficult to make any valid generalization about the content of these various documents. The name of the company, its purposes, and its initial capital seem to be the only items which are universally required to appear in the memorandum. Many of the items which usually appear in a FRENCH or GERMAN memorandum (since there is no other constitutive document) will appear in ENGLISH or AMERICAN internal regulations; examples are matters governing meetings, such as notices, place and time, and order of business. But these items do not have to appear there; nearly anything that commonly appears in the internal regulations may, at the organizers' option, appear in the memorandum instead.

In countries where companies usually have both a memorandum and internal regulations, the primary difference between the two is a matter of hierarchy: the former prevails over the latter. There is a secondary difference; the memorandum is usually more difficult to amend than are the internal regulations. Consequently, the organizers of a company can make certain matters harder to change by putting them in the memorandum, or easier by putting them in the internal regulations.

Because of the differences between the amendment procedures for the memorandum of association and for the internal regulations, the present chapter will treat the two separately. It will first

compare the rules for amending the memorandum of association, more colloquially designated the "charter" (s. 5-29). Later, it will analyze and compare the rules for amending internal regulations in those countries where such a document is used (*infra* s. 30-32).

B. THE PERMISSIBILITY OF CHARTER AMENDMENT

7. *Recognition of the amending power: historical antecedents.* – In the nineteenth century, many legal systems struggled with the question whether charters could be amended at all. The earliest view nearly everywhere seems to have been that the terms of association were permanently binding on everyone involved, like the terms of any other contract. Their temporal limitations were only those expressed or implied in the terms of association – the completion of the enterprise, the expiration of a stated term, or the deaths of the members. This theory was accepted in FRANCE and ENGLAND,¹¹ and infected the UNITED STATES with particular virulence by virtue of the celebrated *Dartmouth College* case.¹² As enunciated in this decision, the corporate charter constituted a contract among the state and all the members, none of whom could change its terms without the consent of all of the others. This strange conception was probably much more palatable than it would be today. Many companies were formed with charters for only a limited time, and organizers believed (much more than we do today) in the stability of existing economic patterns.

It is no longer possible in any modern nation to assert the immutability of charters as a general principle. Most modern company laws provide expressly for amendment in broad terms. The FRENCH and GERMAN statutes grant the power to amend without limitations.¹³ Most AMERICAN statutes concur in declaring that any term which could be included in an original charter can also be inserted in one which is already existing.¹⁴ ENGLAND persists in restricting changes of purpose, but permits unlimited changes in most of the

posed upon it. For the UNITED STATES, see *Ballantine* 63, *Henn* 181. The statutes provide that meetings shall be held, and many other acts done in accordance with the bylaws; hence it is difficult to take action in accordance with the law if no bylaws are adopted.

⁹ *Gower* 409.

¹⁰ *Hornstein* I 348-349.

¹¹ *Rodière and Houin* I no. 482; *Ripert and Roblot* I

no. 1487; *Gower* 15; *Pennington* 52.

¹² *Trustees of Dartmouth College v. Woodward*, 4 Wheat. (17 U.S.) 518, 4 L.Ed. 629 (1819); *Ballantine* 644; *Lattin* 495.

¹³ LSC art. 153; AktG § 179.

¹⁴ Del.G.C.L. § 242; Model B.C.A. § 58.

¹⁵ *Rodière and Houin* I no. 482; *Ripert and Roblot* I no 1485.

other matters which may optionally be inserted in a memorandum (CA s. 5, 23).

The evolution from nineteenth century rigidity to twentieth century flexibility in amendment of charters has been described by FRENCH writers as a change from the "contract" view of a company to the "institutional" view.¹⁵ This characterization rests on the observation that the company is an organism which outlives by far the intentions of those who created it, and the conditions under which it was created; it acquires an identity quite independent of any of its members.

However the evolution in amendability may be characterized, one can easily descry economic forces which have contributed to bringing it about. The unanimity which could perhaps be obtained in the relatively small companies of the early nineteenth century has become progressively less attainable as numbers of shareholders have multiplied. Probably the ease of attaining unanimity even in family companies has also diminished with a general decay in patriarchal authority, and in family solidarity. Accelerating technological and social evolution has necessitated more frequent changes in company structures, and has conditioned investors to tolerate and expect change. Liquidation as an alternative to change has grown less attractive with the rise of capital gains taxes, and with growing recognition of going concern value, or good will, which vanishes like a sleeper's dream when an enterprise is discontinued.

Although amendability has become the general rule in modern marketable share companies, there are still areas in which the ancient immutability persists. These exceptional situations are the subjects of the next few sections.

8. *Companies omitted by the amendment laws.*—If the modern amendability of charters is purely a result of legislation — rather than of a changed judicial view of justice — it will not apply to companies which for one reason or another are not within the ambit of the general company laws of today. In ENGLAND, companies created by act of Parliament or of the Crown are not within the intention of general legislation adopted by Parliament, either before or afterward. Hence they do not benefit from the general grant of amending power. They can amend their charters only insofar as their acts of creation authorize,

which frequently is not at all. Hence, it is generally true that Parliamentary and Crown company charters are not amendable by act of the company, but only by Parliament or the Crown, as the case may be.¹⁶

9. *Retroactivity of amendment laws; the American theories of "impairment of contract" and "reservation of power".* — An interesting question has frequently been presented as to whether laws permitting amendment apply to companies which were already in existence when the laws were passed. Since the power of amendment has been enlarged on many occasions since the middle of the nineteenth century, there have been countless instances where a majority voted for an amendment which was not authorized by law at the time when the minority shareholders became members. If such an amendment is valid, the agreement of association is varied in a manner which the shareholders could hardly have foreseen when they invested their money.

This problem has attracted much attention from theorists, even though it does not very frequently occupy the courts, and has been identified as the problem of "intertemporal conflict of laws."¹⁷ For present purposes, we need not challenge the power of the legislature to decide, for instance, that all shares must vote, or that quarterly reports must be given to shareholders. If, however, the legislature does not wish to impose a mandatory change of rules, may it authorize some of the members of an association to change the rules under which they associate with the other members, against the will of the latter?

This problem presented some difficulty in FRENCH law of the early twentieth century, especially under a law of 1913 which granted the amendment power only in the absence of contrary provisions in the charter. Some of the more recent laws, including the general revision of 1966, have explicitly provided that they apply to existing companies, and that inconsistent charters must be modified to match the new law; these laws have been called "retroactive."¹⁸ If a new law were passed without the inclusion of these provisions, FRENCH theorists would probably divide on its applicability to existing charters, at least where "essential clauses" are involved.

In the UNITED STATES, the question has occasioned much greater difficulty, partly because of a

¹⁶ *Gower* 15; *Re Salisbury Railway & Market House Co.*, (1967) 3 W.L. R. 651 (re-registration of statutory company under Companies Act did not affect the unalterability of its memorandum).

¹⁷ *McNulty, Corporations and the Intertemporal Conflict of Laws*: 55 Calif.L.Rev. 12-74 (1967).

¹⁸ LSC art. 499-500; *Rodière and Houin* I no. 483; Cass. civ. 2 June 1947, J.C.P. 1947.II.3703, note R.C.

clause in the federal constitution which provides that "No State shall... pass any... Law impairing the Obligation of Contracts".¹⁹ Under the contractual view of a company charter, adopted in the *Dartmouth College* case (*supra* n. 12), a law which permits some of the members to change the terms of their association with other members "impairs the contract" among them. Consequently, a state law which enlarges the amending power is precluded by this clause from affecting companies which are already in existence.²⁰

Although everyone solemnly echoes this theory, no one believes that it is desirable to have companies with immutable charters; even the judges who enunciated the original theory recognized its mischievous potentialities. Its vices have therefore been palliated by a second theory, whereby the state may take action before the company is created to "reserve" the power of changing the corporation laws, including the laws about amendment of charter. The "reservation of power" is effectuated by inserting in every corporation code a section which makes the seemingly superfluous declaration that the law "may be amended or repealed at the pleasure of the Legislature",²¹ or other terms of like effect. Some codes also add that the company law "shall be a part of the charter of every corporation", in order to fend off any contention that the law "impairs" the charter (Del. G.C.L. § 394).

Since these "reservations of power" have been faithfully inserted in state company law and constitutions for over a century, it is rare today that a litigant can challenge an amendment on the ground of "impairment of contract". But a successful challenge was made as recently as 1966 by a company which had been formed in Alaska while it was a federal territory. Since the federal government is not inhibited from impairing contracts, the territorial law made no reservation of power. But when ALASKA became a state, it was subject to the impairment clause, and so a state law broadening the amending power was ineffective as to this pre-existing company.²²

Fortunately, the AMERICAN theory of "impairment of contract", with its corollary of "reservation of power", has not been applied to company charters in other countries. It has nothing to recommend it, and should have been repudiated a hundred years ago in the UNITED STATES. In a

rapidly changing society, mutability of charters is indispensable, and should not depend on the incantation of ritual words in the corporation law. Unreasonable amendments by a majority should be controlled by the courts on their merits, without proscribing all amendments. Unreasonable amendment by action of the state (which was involved in the *Dartmouth College* case) can be controlled by the courts in the same ways as other unreasonable state action. In the UNITED STATES, since 1868, this would be by virtue of the "due process" clause²³ and the "*Dartmouth College*" theory is superfluous.

C. PERMISSIBLE SUBJECTS OF AMENDMENT

10. *Exclusion of certain subjects from amendment.* — Although complete immutability of company charters is virtually obsolete, there are a number of valid or arguable bases for excluding amendments on particular subjects. These may be conveniently categorized as: (1) Express legislative exclusion; (2) closed legislative list of permissible amendments; (3) charter declaration excluding amendment; (4) inviolable individual rights.

Express legislative exclusions are illustrated by the FRENCH law which forbids increasing shareholders' obligations, or changing the company's nationality except under stated conditions (LSC art. 153-154).

Closed lists are found in some of the UNITED STATES and in ENGLAND. The DELAWARE law lists a number of proper subjects of amendment (purposes, corporate name, amount of capital) (G.C.L. §242). Although it concludes with a general clause ("Any other change... that may be desired"), a famous DELAWARE decision limited the general clause to matters which were deemed to be on the same plane as the matters specifically mentioned.²⁴ There would be no basis for this type of decision under the Model Act, which declares that an amendment may contain anything which could be put in an original charter.²⁵

In ENGLAND, there is still a closed list of reasons for which the purpose may be changed (CA s. 5) although the Jenkins Committee recommended its abolition.²⁶ These reasons have been broadly interpreted, but some desired amendments

¹⁹ U.S. Const. art. I s. 10 par. 1.

²⁰ *Ballantine* 645; *Lattin* 495.

²¹ Del. G.C.L. § 394; cf. Model B.C.A. § 149.

²² *State v. Alaska Airlines*, 413 P.2d 352 (Wash. 1966); see also *Hanks v. Borelli*, 411 P.2d 27 (Ariz. 1966).

²³ U.S. Const. amend. XIV.

²⁴ *Keller v. Wilson & Co.*, 21 Del. Ch. 391, 190 A. 115 (1936).

²⁵ Model B.C.A. § 53; see *Henn* 540.

²⁶ *Jenkins Report* par. 45-49.

have been excluded.²⁷ The closed list approach was also applied in some of the earlier FRENCH amendment laws;²⁸ it does not appear in the latest FRENCH and GERMAN laws.²⁹

If the incorporators want to exclude amendments on particular subjects, may they do so by a declaration in the charter? The answer to this question would seem to be negative in most instances. The legislature having declared in favor of mutability, the shareholders cannot renounce it.³⁰ However, some laws expressly permit the shareholders to put certain subjects off limits. This is illustrated by the English statute which permits the memorandum to prohibit changes of particular subjects by express statement to this effect (CA s.23(1,2)). Rights protected by provisions in the memorandum have been called "entrenched rights".³¹

A fourth source of immunity to amendment is the idea that some of the shareholders' expectations are so definite and valuable that they are inviolable. This seems to be the essential core of the former FRENCH *droits essentiels*,³² the GERMAN *Sonderrechte*,³³ and the AMERICAN "vested rights."³⁴ These concepts have been particularly associated with the phenomenon of preferred shares. The inviolable rights of common shareholders would be violated by issuing new preferred shares (a FRENCH view); the inviolable rights of preferred shareholders would be violated by modifying their preference claims after their dividends are in default (an AMERICAN view; see *infra* s. 13).

11. *Amendment of purposes.* — The mutability of the purposes for which a company exists — usually stated in terms of the kinds of commodities or services in which it will deal — is a classic subject of litigation. In the 1860's AMERICAN lawyers debated whether a company which had been organized to operate a railroad five miles long could amend its charter to make the road 17 miles long; the court's answer was negative.³⁵ Today all modern countries admit changes in purpose, usually without limitation.³⁶ ENGLAND is peculiar in presenting an exclusive list of

acceptable reasons for changing the purposes. These seem to be designed to prevent the company's launching into a business completely unrelated to its original one, or, in *Gower's* terms, to prevent an investor in gold mining from finding his capital at risk in a fried fish shop (p. 82).

The ENGLISH arrangement has produced some interesting and presumably expensive litigation in the High Court without usually preventing the change of purpose which the management desires.³⁷ Some permitted amendments have been quite broad; a company organized for the purpose of manufacturing tires was permitted to become a diversified investment company.³⁸ The principal case cited for a negative decision did not involve a business corporation, but a non-profit association formed to promote the interests of bicyclists. The Lords Justices of 1907 forbade it to amend its charter in order to promote also the interests of automobilists.³⁹

The persistence of restrictions on change of purpose in ENGLISH companies seems distinctly anachronistic. It is related to the peculiar views of the ENGLISH courts on *ultra vires* transactions,⁴⁰ which have been condemned by nearly all BRITISH writers.⁴¹ The Board of Trade committee on company law recommended in 1962 the removal of restrictions on change of purpose.⁴² Although the restrictions remain nominally a part of the law, they can be invoked only by a very alert opposition. If the opposition fails to sue to set aside an alteration within 21 days, it is too late.⁴³ Thus ENGLAND seems to be on the way to joining other modern nations in permitting change to any lawful purpose which a qualified majority of the company desires. At least two of her daughters-in-law — AUSTRALIA and CANADA — have already taken this step.⁴⁴

Statutes which purport to permit unlimited amendments of purpose, like the contemporary AMERICAN statutes, may have a concealed limitation on the purposes to which the company can amend. Expressly or implicitly, the laws limit

²⁷ *Pennington* 43-50.

²⁸ *Ripert and Roblot* I no. 1494.

²⁹ LSC art. 153; AktG § 179.

³⁰ LSC art. 153 par. 1, after declaring the shareholders' power to amend, states that all contrary provisions are ineffective. This codifies prior law: *Ripert and Roblot* I no. 1488; *Rodière and Houin* I no. 483.

³¹ *Gower* 458.

³² *Ripert and Roblot* I no. 1487.

³³ *Würdinger* 48; CC § 35.

³⁴ *Ballantine* 649; *Henn* 539.

³⁵ *Zabriskie v. Hackensack & N.Y.R. Co.*, 18 N.J.Eq.

178, 90 Am.Dec. 617 (1867).

³⁶ See LSC, AktG, Del.G.C.L., Model B.C.A., CA.

³⁷ See review of cases in *Pennington* 45-50.

³⁸ *Re Parent Tyre Co.*, (1923) 2 Ch. 222.

³⁹ *Re Cyclists Touring Club*, (1907) 1 Ch. 269.

⁴⁰ *Gower* 85-87.

⁴¹ *Idem* 93; *Pennington* 67; *Jenkins Report* par. 43.

⁴² *Jenkins Report* par. 45-49.

⁴³ CA s. 5(9); *Pennington* 49.

⁴⁴ AUSTRALIA: Company Law s. 21, 28; CANADA: Companies Act s. 17.

amendment to any provision which could be included in an original charter under the same company code.⁴⁵ But AMERICAN laws commonly exclude certain kinds of companies, such as banks, insurance companies and railroads from incorporation under the general business corporation laws.⁴⁶ These kinds of companies must be formed under special acts applicable only to them. Consequently, an AMERICAN manufacturing corporation cannot in most states amend its purpose to include banking, nor can a bank amend its purposes to include insurance underwriting. This would be theoretically possible in FRANCE or GERMANY, where financial, railroad, and industrial companies are all formed under the same company law. However, since banks and railroads are strictly regulated, if not nationalized, in all industrialized countries, there is no more real freedom in GERMANY than in the UNITED STATES for a bank or railroad to switch its assets into producing transistor radios.

12. *Amendments increasing the obligations of shareholders.* — The laws of most countries agree that amendments which increase the shareholder's obligations to the company cannot be made against the dissent of any shareholder. This inhibition seems to have originated with judicial decisions, but is now expressly stated in most of the codes.⁴⁷ It applies most obviously to an amendment which would increase the par value of shares (without transferring surplus), thereby making each shareholder liable for an increased payment on his share. Another interesting instance occurred in a GERMAN case, where shareholders in a beet sugar factory were obliged by the charter to raise beets, and deliver them to the factory for processing, subject to a specified penalty for non-compliance. A charter amendment which increased the penalty was held invalid.⁴⁸

Many AMERICAN company laws are silent on this question; neither the DELAWARE law nor the Model Act has anything to say about it. But it is a frequent subject of legislation and litigation in the WESTERN states. When mining companies have exhausted their resources but not their hopes,

they seem to have a custom of amending their charters to permit assessing their shareholders for additional payments, even though the shares were issued as fully paid and nonassessable.⁴⁹ The assessment is usually enforced by sale of the assessed shares if the assessment is not paid, rather than by enforcing a personal liability of the shareholder. Legislation expressly permits such amendments in CALIFORNIA (G.C.L. §3634) and MONTANA (G.C.L. §15-721). In the absence of such legislation, UTAH and IDAHO courts invalidated similar amendments.⁵⁰ The CALIFORNIA law expressly excludes an amendment making the shareholder personally liable for the assessment without his consent.

Even when the amendment permits only an assessment to be enforced by sale of the shares, it encounters the adverse opinion of AMERICAN legal scholars. They have concurred in the view that the assessment of "fully-paid" shares is too violent a trespass on shareholders' expectations.⁵¹ Their opinion gains confirmation from the EUROPEAN company codes.

13. *Amendments impairing the rights of particular classes of shareholders.* — When hard times beset a company, its managers are irresistibly impelled to demand sacrifices from the shareholders. If the company needs more money, but it cannot be raised by issuing more common shares, the directors may propose issuing a preferred class which will take priority over the common shares. Later, when the preferred dividends are in arrears, the directors may propose to cut them down, so that dividends on the common shares can be resumed sooner. Cases of this type have raised questions about the validity of amendments which change the rights of particular classes of shareholders.

A surprising range of legal positions exists today in countries whose company laws in other respects have attained similar degrees of flexibility. On the extreme right, we encounter the view that rights of particular classes of shareholders are somehow immune to the right of amendment which applies to other aspects of the company charter. This appears to be the ENGLISH position

⁴⁵ Del.G.C.L. § 242(a), last par.; Model B.C.A. § 58 par. 1.

⁴⁶ Del.G.C.L. § 101 (banking, in-state public utilities); Model B.C.A. § 3 (banking, insurance).

⁴⁷ CA s. 22; LSC art. 153 par. 1; AktG § 180; Del. G.C.L. § 109, 242.

⁴⁸ RG 8 June 1928, RGZ 121, 238.

⁴⁹ See *Wilson v. Cherokee Drift Mining Co.*, 14 Cal. 2d 56, 92 P.2d 802 (1939); *Frost & Co. v. Coeur d'Alene Mines Corp.*, 60 Idaho 491, 92 P.2d 1057 (1939); *Som-*

erville v. St. Louis M. & M. Co., 46 Mont. 268, 127 P. 464 (1912); *Garey v. St. Joe Mining Co.*, 32 Utah 497, 91 P. 369 (1907).

⁵⁰ Cases *supra* n. 49; see also Utah B.C.A. (1961) § 16-10-4.

⁵¹ *Ballantine* 647-648; *Curran*, *Minority Shareholders and the Amendment of Corporate Charters*: 32 Mich. L.Rev. 743-779, 791-792 (1934); *Dodd*, *Dissenting Shareholders and Amendments to Corporate Charters*: 75 U.Pa.L.Rev. 723-752, 731-732 (1927).

with regard to class rights which are stated in the memorandum of association, unless the memorandum itself provides for means of amendment.⁵² It was the prevailing view of FRENCH law until early in the twentieth century by virtue of the theory of "essential clauses"⁵³. In GERMANY, it applies to class rights during the first five years after the shares are issued.⁵⁴ In the UNITED STATES, it survives in DELAWARE and a few other states with respect to a narrow class of rights – the claim of cumulative preferred shareholders to receive their arrearages of preferred dividends before any are paid on the common shares.⁵⁵

This seeming rigidity has been deprived of most of its practical importance. The ENGLISH position is usually escaped by stating the rights of the various classes of shareholders in the "articles" (which we have called "internal regulations" – *supra* s. 6) rather than in the memorandum, and by including in the same document provisions for amending the articles.⁵⁶ Since some unsophisticated incorporators would probably omit these amendment clauses if left to themselves, the company law includes them among a set of provisions which automatically become the articles of every company unless expressly rejected.⁵⁷ If a perverse draftsman should reject these clauses, they could perhaps be added by amendment, thus opening the way for a second amendment which would modify class rights;⁵⁸ but the clauses are nearly always there, and the point has not been precisely ruled on. As a counterpoise to the power of alteration, ENGLISH law asserts the duty of the courts to set aside the amendment for unfairness, on petition of 15 percent of the affected class.⁵⁹

In FRANCE, the "essential clauses" theory has been categorically excluded since the first decades of the twentieth century by broad amendment laws (*supra* n. 53); it is survived only by a very limited group of "individual rights" such as voting or

transferring shares.⁶⁰ The GERMAN inhibition applies only to the first five years after issue – a period during which fundamental changes are seldom even proposed (*supra* n. 54).

In the UNITED STATES, most class rights are clearly subject to amendment under present corporation laws (model B.C.A. §53). A few states have broadened their laws sufficiently to eliminate any hiding place for that paradigm of the vested rights – the "accrued dividends" of cumulative preferred shares.⁶¹ In DELAWARE and others, which still maintain a facade of conservatism on this point, the courts have created an escape hatch, permitting companies to eliminate their arrearages by a merger with a wholly-owned subsidiary.⁶² In addition, courts have tolerated a great many ways of inducing preferred shareholders to surrender their dividend arrearages "voluntarily" – by exchanging their present shares and arrearages for new prior preferred shares without arrearages, or by selling their shares to the company at the depressed market price.⁶³

The struggle over the mutability of class rights has been long and litigious, with voluminous debate among scholars and lawyers. In ENGLAND there is still some doubt about whether class rights can be changed if the magic formulas were omitted from the original articles (a rare occurrence).⁶⁴ In practice, class rights are usually as changeable as everything else about a company. The shareholders' protection against change depends (in descending order) on (a) the management's desire to maintain the reputation of the company's securities, (b) the courts' disposition to combat fraud and unfairness,⁶⁵ and (c) the other shareholders' alertness and firmness in rejecting the erosion of their rights. Only the second of these is in the hands of the courts (*infra* s. 28).

The history of class rights thus appears to have

⁵² CA s. 23(2); *Gower* 464. Prior case law was in accord, *Palmer's Law* (1938) 69.

⁵³ *Houpin and Bosvieux* II (1935) no. 1235; *Ripert and Roblot* I no. 1487; *Rodière and Houin* I no. 482.

⁵⁴ AktG § 26 par. 4; *Würdinger* 171–172.

⁵⁵ *Becht*, Alteration of Accrued Dividends: 49 Mich. L.Rev. 363–394, 565 (1961); *Ballantine* 652–653.

⁵⁶ *Gower* 465; *Jenkins Report* par. 190.

⁵⁷ CA, Sch. I, Table A, Part I reg. 4.

⁵⁸ *Gower* 466.

⁵⁹ CA s. 72(1, 2, 3); *Pennington* 154.

⁶⁰ *Ripert and Roblot* I no. 1496; *Rodière and Houin* I no. 483.

⁶¹ N.Y.B.C.L. § 801(b) (12): "To fix, change or abolish ... any provisions in respect of any undeclared dividends, whether or not cumulative or accrued ..."

⁶² *Federal United Corp. v. Havender*, 24 Del.Ch.318, 11 A.2d 331 (1940); *Becht* (*supra* n. 55).

⁶³ *Becht*, Corporate Charter Amendments – Issues of Prior Stock and the Alteration of Dividend Rates: 50 Colum.L.Rev. 900–944 (1950); *Conard*, Manipulation of Share Priorities – The Record of 79 Listed Securities: 8 Vand.L.Rev. 55 (1954); *Dodd*, Accrued Dividends in Delaware Corporations – from Vested Right to Mirage: 57 Harv.L.Rev. 894–899 (1944).

⁶⁴ *Gower* 464–469.

⁶⁵ *Dodd*, Fair and Equitable Recapitalizations: 55 Harv.L.Rev. 780–818 (1942); *Latty*, Fairness – The Focal Point in Preferred Stock Arrearage Elimination: 29 Va.L.Rev. 1–52 (1942); *Walter*, Fairness – A Disappearing Doctrine: 29 B.U.L.Rev. 453–485 (1949).

recapitulated the already familiar story of the mutability of charters. The only difference is that class rights surrendered to change a little later, after a more protracted struggle. The resulting situation is not at all comforting. In the present writer's opinion preferred shares have been needlessly deprived of investment soundness.⁶⁶ But a return to immutability (even if it were possible) would be much too rigid a solution. What is needed, is the opinion of most serious commentators on the subject, is a more vigorous exercise of the courts' power to determine the fairness of amendments of class rights.⁶⁷

14. *Amendment changing the nationality of a company: expatriation of the seat. - Overview of the problem.* - Among EUROPEANS, one of the most engaging subjects of legal speculation in recent years has been the possibility of a company's changing its nationality by amending its charter.⁶⁸ The subject is inherently a difficult one, and its complexity is aggravated by the diversity of meanings of "nationality." In its aboriginal sense, "nationality" is a characteristic of physical persons, not of corporations - signifying their genetic strain, their culture, their language, and their political loyalty. Even on a legal plane, nationality denotes primarily the rights of a human being to reside, to receive a passport, and to vote, and the duty of military service. None of these aspects of nationality is applicable to a corporation.⁶⁹

These difficulties have led some writers to avoid the use of the "nationality" concept in relation to corporations, or even to deny its applicability.⁷⁰ This tendency is quite marked in a number of LATIN-AMERICAN states, led by ARGENTINE scholars.⁷¹ One of the latter declared, "Juridical persons are neither national or foreign."⁷²

But most jurists find it unavoidable to employ the concept of corporate nationality, even while recognizing its multivalence. It is used in widely

varying contexts. A corporation may be characterized as a "national" of a friendly country for the purpose of recognizing its treaty rights, or as a "national" of an enemy country for the purpose of seizing its property. Finally it may be recognized as a "national" of a particular country for the purpose of applying to it the domestic "company law" of that country to govern the relations among its members and the procedure by which their rights should be determined. This kind of law has been called by *Rabel* the "personal law" of the corporation, by analogy to the "personal" law which governs an individual's rights of marriage, divorce and inheritance.⁷³ Following this analogy, *Rabel* declared that a corporation's personal law "accompanies the legal entity from birth to death."⁷⁴

When EUROPEAN writers discuss the change of corporate nationality by amendment, they use "nationality" primarily in relation to the governing "personal law of the corporation," as *Rabel* used that term.⁷⁵ But "nationality" cannot be used in this way in federated nations like the UNITED STATES, CANADA and AUSTRALIA, because the "personal law" of companies is not fixed by national law. It is fixed by the separate law of each state.⁷⁶ One might invent a new term, such as "statality." It seems wiser to abandon this search for an abstraction, and to use a more descriptive term, the "governing law of the company," to describe the regime which regulates the legal relations between the company and its shareholders, and among the shareholders. The question may then be rephrased, "Can a company, by amending its charter, change its governing law?"

Express change of governing law: multiple domicile. - No record has been found of a company which purported simply to renounce one governing law, and adopt another, nor is such an amendment discussed by legal writers. The FRENCH company

⁶⁶ *Conard* (supra n. 63); *Gower* 469.

⁶⁷ *Ballantine* 653-662; *Dodd, Latty, Walter* (supra n. 65); cf. *Jenkins Report* par. 189.

⁶⁸ *Beitzke*, Anerkennung und Sitzverlegung von Gesellschaften und juristischen Personen im EWG-Bereich: ZHR 127 (1965) 1; *Coleman*, Transfer of a Company's Principal Office: Rapports généraux au Ve congrès international de droit comparé (Brussels 1960) 289; *Koumantos*, Transfert du siège et changement de la nationalité d'une société anonyme: Rev.Hell. 17 (1964) 387-396; *Loussouarn*, Transfert 227; *Meier-Hayoz*, Sitzverlegungen juristischer Personen von und nach der Schweiz: Schweizerische Beiträge zum fünften Kongress für Rechtsvergleichung 1958, 63.

⁶⁹ *Van Hecke*, Nationality of Companies Analyzed: N.T.I.R. 8 (1961) 223; *Loussouarn*, La condition de

personnes morales en droit international privé: Rec. des Cours 96 (1959 I) 447-503, 453.

⁷⁰ *De Sola Cañizares*, Derecho 41-51; *Niboyet*, Précis de droit international privé (Paris 1928) 110; *idem*, Traité de droit international privé français II (Paris 1947) 341; cf. *Pillet*, Traité de droit international privé II (Paris 1923) 781.

⁷¹ *Aztiria* 37-41; *De Sola Cañizares* (supra n. 70); *Malagarriga* 547.

⁷² *Aztiria* 40.

⁷³ Cf. *Batiffol*, Observations sur le problème de la nationalité des sociétés: Studi Angelo Sraffa (Padova 1962) 67.

⁷⁴ *Rabel* (-Drobnig) II 69.

⁷⁵ *Batiffol* (supra n. 73); *Rabel* (-Drobnig) *ibid.*

⁷⁶ Cf. *Henn* 102.

law has a provision which permits a company to "change its nationality" where authorized by treaty (LSC art. 154) and MEXICO has one without this limitation (Ley gen. art. 182); both of these are understood by commentators to denote a change resulting from a transfer of the company's principal office from one country to another.⁷⁷ A charter amendment which purported to change the company's governing law *without* changing the company seat would almost certainly be regarded as outside the contemplation of the amendment laws. In the UNITED STATES, its invalidity would be confirmed in a number of states by the provision that limits amendment to clauses which could be inserted in an original charter.⁷⁸

However, something fairly close to a change of governing law has been recognized by various AMERICAN states. This is the phenomenon of "domestication" under the law of two or more different states, all of whose regimes become binding on the company. This status has frequently been sought by interstate railroad companies who want to obtain the advantages of "domestic corporation" status in several states. The Chicago Rock Island and Pacific Railroad Co., *e.g.*, was a corporation of the states of both ILLINOIS and IOWA from 1866 to 1948, when it was reorganized under the laws of DELAWARE.⁷⁹ Some other companies acquired dual governing laws through "domestication" in one or more states in which they were originally "foreign," and the laws of a few states expressly provide for such a procedure.⁸⁰ But these changes do not involve a renunciation of original governing law; the company remains subject to the governing law of the state of incorporation, while subjecting itself simultaneously to additional regimes.

It is, of course, common for AMERICAN enterprises to abandon one governing law and adopt another, but not without abandoning the original company shell. Traditionally, the original

company makes a "sale" of all its assets to a newly formed company of another state; the consideration for the sale is not money, but shares, which are received by the original company, and eventually distributed to its shareholders on dissolution.⁸¹ More recently, interstate merger has been used to transfer an enterprise from one state regime to another.⁸² Neither of these techniques seems to be used or usable for changes from one nation to another.

Change of national location of company seat. — The specific problem which intrigues EUROPEAN writers on "change of nationality" is an amendment of the charter to declare that the seat of the company will henceforth be in some other nation.⁸³ This may be called an "expatriation of the seat." Under the traditional rules of private international law in FRANCE and GERMANY, the company's governing law (the "personal law of the company" in *Rabel's* phrase) depends on the location of its seat.⁸⁴ Consequently, a charter amendment to expatriate the seat implies adopting a new governing law, and escaping the rules under which the company was originally formed.

This precise problem does not arise in ENGLISH or AMERICAN law, because the charter does not usually declare where the principal office is.⁸⁵ In the UNITED STATES, the charter need only declare where the company maintains a registered office within the state,⁸⁶ in ENGLAND, it need only declare whether the registered office is in ENGLAND or SCOTLAND (CA s.2(1) (b)). In neither country does the company need to state where its *principal* office is, nor does the company's governing law depend on its location.⁸⁷

The *actual* removal of the head office of an ENGLISH company (which requires no amendment of charter) has been a subject of some concern, because of tax law provisions which exempt from income tax companies whose "residences" as well as their activities are abroad.⁸⁸ ENGLISH tax law forbids such a removal without permission of the Treasury.⁸⁹ But there is no doubt about the

⁷⁷ *Loussouarn*, *Transfert* 231; *Mantilla Molina* 351; *de Pina Vara* 54.

⁷⁸ Del.G.C.L. § 242(a) par. 3; Model B.C.A. § 58 par. 1.

⁷⁹ *Moody's* Transportation Manual (New York 1966) 1389. See also *Fitzgerald v. Southern Railway*, 176 F.Supp.445 (S.D.N.Y. 1959) in which the Southern Railway showed itself to be simultaneously "incorporated and existing under the laws of six states."

⁸⁰ *Stevens and Henn* 337.

⁸¹ This method was employed by *Ford Motor Co.* to move from MICHIGAN to DELAWARE, and by the *Rock Island Railroad* in 1948, *Moody's* (*supra* n. 79).

⁸² *E.g.*, *United States Steel Corp.*, *Moody's* Industrial

Manual (New York 1966) 2229.

⁸³ *Beitzke, Coleman, Koumantos, Loussouarn, Meier-Hayoz* (*supra* n. 68).

⁸⁴ *Batiffol* (*supra* n. 73); *van Hecke* (*supra* n. 69) 223; *Rabel* (-*Drobnig*) II 31; *Loussouarn, Confits* 102; *Loussouarn* (*supra* n. 69); *Rotondi, Nationalité; cf. Würdinger* 19.

⁸⁵ See form in Model B.C.A. Anno. III (1960) 160.

⁸⁶ Del.G.C.L. § 102(2); Model B.C.A. 54(i), 125(b).

⁸⁷ *Rabel* (-*Drobnig*) II 31 ss.; *Restatement of Conflict of Laws* (1934) § 182-191.

⁸⁸ *Gower* 170-171; *Pennington* 5-6.

⁸⁹ *Gower* 171.