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# Continued Use of *Hanna v. Plumer* as an Alternative to Deciding the Constitutionality of State Foreign Corporation Registration Laws

John T. Arnold

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tegral part test, which the Tenth Circuit enunciated in that decision. The case fails to provide any precise definition of "integral part." Therefore, the decision fails to provide any real guidance for future courts or for future litigants. Furthermore, there is a strong federal policy that Congress has the power to prescribe rules for federal courts and that such rules should be uniform. Using the integral-part test, as the court did in *Chappell*, seems to go against this policy. In some cases rule 3 would apply, while in others it would not.

Finally, it can be seen that to be safe plaintiffs in diversity suits should follow the state commencement procedure as closely as possible. By so doing they can protect themselves from possible dismissal of their cause of action because of confusion over whether rule 3 or the state commencement statute is applicable for tolling purposes. Until the Supreme Court agrees to hear a case such as *Chappell*, the confusion surrounding the applicability of rule 3 will continue. Questions such as the vitality of the *Ragan* decision and the applicability of rule 3 for the purposes of tolling a state statute of limitations must ultimately be answered by the Court. Until that time courts must struggle with the present conflict in this area.

*Donald H. Snell*

### Continued Use of *Hanna v. Plumer* as an Alternative to Deciding the Constitutionality of State Foreign Corporation Registration Laws

Avondale brought suit against Propulsion in a Louisiana state court. Propulsion demonstrated diversity of citizenship and removed the case to a federal district court sitting in Louisiana. After removal of the case Propulsion asserted a compulsory counterclaim pursuant to rule 13(a) of the Federal Rules of Civil Procedure.<sup>1</sup> Avondale then made a motion to dismiss Propulsion's counterclaim, contending that Propulsion lacked the capacity to sue or bring any judicial demand in Louisiana. Avondale's position was based on the Louisiana statute that precludes a foreign corporation from asserting any judicial demand in Louisiana until such time as it has been duly authorized to transact business in the state.<sup>2</sup> *Held, motion to dismiss the counterclaim denied:* Pursuant to the holding in *Hanna v. Plumer*,<sup>3</sup> rule 13(a) prevails over an inconsistent state foreign corporation statute when suit is removed to a federal court sitting in diversity. *Avondale Shipyards, Inc. v. Propulsion Systems, Inc.*, 53 F.R.D. 341 (E.D. La. 1971).

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<sup>1</sup> FED. R. CIV. P. 13(a) provides in part:

A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction.

<sup>2</sup> LA. REV. STAT. § 12:314(A) (1969).

<sup>3</sup> 380 U.S. 460 (1965).

## I. ERIE AND ITS PROGENY

The landmark decision of *Erie Railroad v. Tompkins*<sup>4</sup> established the principle that federal courts sitting in diversity jurisdiction must apply both the case and statutory law of the forum state with respect to substantive rights and obligations.<sup>5</sup> In *Guaranty Trust Co. v. York*,<sup>6</sup> decided seven years after *Erie*, the Supreme Court held that the choice between state or federal law was to be based on an "outcome-determinative"<sup>7</sup> test, with state law being applied whenever failure to do so might produce a different result from that which would be reached by a state court. By proclaiming this standard, the Court was seeking to implement the uniformity of result commended by *Erie*.<sup>8</sup>

In *Woods v. Interstate Realty Co.*<sup>9</sup> the Court reaffirmed the principles in *Guaranty Trust* and held that a federal court sitting in Mississippi must apply a state law which denied access to the state courts to foreign corporations doing business in that state without conforming with its registration requirements.<sup>10</sup> In an attempt to delineate the limits of the outcome-determinative test,<sup>11</sup> the Court in *Byrd v. Blue Ridge Electric Cooperative, Inc.*<sup>12</sup> limited the strict interpretation given the test in *Woods*. In its place, the Court stated that a diversity court must ascertain whether there were any countervailing considerations of federal policy sufficiently compelling to justify disregarding the state rule.<sup>13</sup> Thus, the notion that a federal court sitting in a diversity action is merely an extension of the state judicial system was put to rest.

In 1965, in *Hanna v. Plumer*,<sup>14</sup> the Court was for the first time presented with the situation in which there was a direct conflict between a federal rule and a state rule. There the plaintiff sued the executor of an estate in a Massachusetts federal district court to recover damages for personal injuries caused by the defendant's decedent. Process was served by leaving a copy of the summons with the executor's wife at his residence. Under rule 4(d) such service was valid notice of the action. But, under Massachusetts state law, such service was not adequate. The Court resolved the conflict by proclaiming that *Erie* was not the appropriate test of the validity and applicability of a federal rule.<sup>15</sup>

<sup>4</sup> 304 U.S. 64 (1938).

<sup>5</sup> The determination of what rights and obligations are "substantive," as opposed to procedural, is of course a part of the problem discussed in this Note. See note 20 *infra*.

<sup>6</sup> 326 U.S. 99 (1945).

<sup>7</sup> *Id.* at 109.

<sup>8</sup> Two years later in *Angel v. Bullington*, 330 U.S. 183 (1947), the Court was faced with a North Carolina statute that prohibited suits for deficiency judgments on purchase money mortgages. The Court held that the action brought in a North Carolina federal court must be dismissed since the court was "in effect, only another court of the state." *Id.* at 187. For a comprehensive study of the effect of this decision see Farinholt, *Angel v. Bullington: Twilight of Diversity Jurisdiction?*, 26 N.C.L. REV. 29 (1947).

<sup>9</sup> 337 U.S. 535 (1949).

<sup>10</sup> The opinion pointed out that *Angel* and *Guaranty Trust* provided the controlling theory "that a right which local law creates but which it does not supply with a remedy is no right at all for purpose of enforcement in a federal court in a diversity case; that where in such case one is barred from recovery in the state court, he should likewise be barred in the federal court." *Id.* at 538.

<sup>11</sup> This test has provoked widespread criticism among the writers. See Hart, *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489, 512 (1954).

<sup>12</sup> 356 U.S. 525 (1958).

<sup>13</sup> *Id.* at 537-38.

<sup>14</sup> 380 U.S. 460 (1965).

<sup>15</sup> *Id.* at 469-70.

The Court distinguished *Woods* as involving situations in which the federal rule is not as broad as the losing party urged, and, there being no federal rule, state law was made applicable by the *Erie* doctrine.<sup>16</sup> Contrasting a situation in which a "relatively unguided *Erie* choice"<sup>17</sup> is present, the Court found the command of the federal rules to be clear.<sup>18</sup> The Court determined that the *Erie* rule, and the guidelines set down in *Guaranty Trust*, were created to protect the states' substantive regulation of the primary conduct and activity of its citizens.<sup>19</sup> Absent such a state purpose, the Court held itself compelled to apply the federal rule in the face of congressional desire to bring about uniformity in the federal courts.<sup>20</sup>

## II. OPENING THE DOORS OF THE FEDERAL COURTS

Statutes governing the registration of foreign corporations have been enacted in all fifty states.<sup>21</sup> The penalties for non-compliance vary from the voiding of all contracts<sup>22</sup> to the restriction of access to the state's courts.<sup>23</sup> A corporation doing business within a state other than that of its incorporation must register as a condition to its enjoyment of the substantive rights accorded the citizens of the state.<sup>24</sup> Present federal statutes provide that a corporation is a citizen of both the state of incorporation and the state in which it has its principal place of business.<sup>25</sup> In addition, a corporation is subject to the jurisdiction of the courts of any state in which it is "doing business."<sup>26</sup> In clarifying what corporate actions constitute "doing business," the Supreme Court has stated that certain minimum contacts create a relationship with the forum state to such an extent that requiring a corporation to defend in an action brought in the forum state "does not offend traditional notions of fair play and substantial justice."<sup>27</sup>

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 471.

<sup>18</sup> The validity of this command is to be tested not by the *Erie* doctrine, but by the constitutional power of Congress to prescribe federal rules and by the meaning of the Rules Enabling Act of 1934, 28 U.S.C. § 2072 (1971), through which Congress has exercised that power. 380 U.S. at 472-74.

<sup>19</sup> *Id.* at 475 (Harlan, J., concurring). It has been suggested that a substantive rule is one that influences the primary behavior of a citizen in his everyday life, while a procedural rule affects only judicial housekeeping regulating the fair disposition of cases in court. *See, e.g., Note, Erie, Forum Non Conveniens and Choice of Law in Diversity Cases*, 53 VA. L. REV. 380, 393-94 (1967); *Note, Choice of Procedure in Diversity Cases*, 75 YALE L.J. 477, 482-85 (1966).

<sup>20</sup> 380 U.S. at 471.

<sup>21</sup> *See, e.g.,* ARIZ. REV. STAT. ANN. § 10-481 (1956); ILL. REV. STAT. ch. 32, § 157.102 (1953); MO. REV. STAT. § 351.570 (1959); WASH. REV. CODE ch. 23A.32 (1969).

<sup>22</sup> *See, e.g.,* MICH. COMP. LAWS §§ 450.93, 450.95 (1967); VT. STAT. ANN. tit. 11, §§ 691, 764 (1958).

<sup>23</sup> ILL. REV. STAT. ch. 32, §§ 157.102 (1953), 157.109 (1933), 157.125 (1949); TEX. BUS. CORP. ACT ANN. art. 8.18 (1969). It has been suggested that the state purpose and policy behind foreign corporation registration laws is a desire to force the out-of-state corporation to admit, by registering, that it is in fact "doing business" within the state, thus subjecting it to state taxation. *Note, Diversity Jurisdiction: State Door-Closing Legislation Under the Erie Doctrine*, 66 COLUM. L. REV. 377 (1966). A comprehensive study of the tax factors involved is presented in Walker, *Foreign Corporation Laws: A Current Account*, 47 N.C.L. REV. 733, 743 (1969).

<sup>24</sup> *See* note 21 *supra*, and accompanying text.

<sup>25</sup> 28 U.S.C. § 1332(c) (1971).

<sup>26</sup> *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

<sup>27</sup> *Id.* at 316.

*The Impact of Woods.* The effect of the minimum contacts test has been to subject a relatively small interstate corporation to heavy penalties through the strict application of *Woods*.<sup>28</sup> Such use of *Woods* in these situations has all but financially ruined some corporations.<sup>29</sup> It has been suggested that such results place an undue financial burden upon the economy of the nation as a whole.<sup>30</sup> In the face of several shocking results, federal trial and appellate judges in recent decisions have attempted to avoid the *Woods* decision and the result that it necessarily demands. In 1953, a federal district court sitting in Texas simply refused to follow *Woods* by saying that "it would be an unseemly surrender of sovereignty for the federal judiciary to be ruled by state statutes as to the right to enter a national court."<sup>31</sup> The Fifth Circuit, while not voicing such a candid refusal, managed to find an exception to the *Woods* rule. The Fifth Circuit held that foreign corporation statutes "will not be construed to deal with suits on interstate transactions; and that if they are so construed, they will not be upheld."<sup>32</sup>

*Byrd and Countervailing Federal Policies.* The expansion of the outcome-determinative test in *Woods* met stiff qualification in the *Byrd* decision. Justice Brennan, acknowledging that the facts in *Byrd* probably were adapted to the use of the outcome test, nevertheless formulated a new area of inquiry.<sup>33</sup> The first step in determining the choice of law was to determine whether the proposed state rule was bound up with the state-created rights and obligations sought to be enforced. If not, the importance of the federal law to the uniform administration of cases in the federal courts was to be weighed against the state policy involved.<sup>34</sup> In *Szantay v. Beech Aircraft Corp.*<sup>35</sup> the Fourth Circuit formulated a thoughtful guide for applying the standard of *Byrd*. In essence, this guide provided that state provisions, whether substantive or procedural, must be applied by the federal courts if sufficiently bound up with the substantive right or obligation at issue; but, if a state procedural provision is not so bound up, the federal court may disregard it in the face of affirmative countervailing considerations.<sup>36</sup> In finding that the state's reason "for enacting its 'door-closing' statute was uncertain," the court found a clear countervailing federal consideration: "the constitutional extension of subject-matter jurisdiction to the federal courts in suits between citizens of different states."<sup>37</sup> It would seem that the countervailing federal considerations needed to reject a state rule not affecting substantive rights were made available by the *Hanna* Court's reliance on the

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<sup>28</sup> See, e.g., *Bowman v. Curt G. Joa, Inc.*, 361 F.2d 706 (4th Cir. 1966); *Kuchenig v. California Co.*, 350 F.2d 551 (5th Cir. 1965).

<sup>29</sup> *Hicks Body Co. v. Ward Body Works*, 233 F.2d 481 (8th Cir. 1956). Here an Indiana corporation was not allowed to sue an Arkansas corporation in an Arkansas federal court for the alleged breach of a contract to manufacture 12,000 school buses.

<sup>30</sup> See Note, *A Critical Evaluation of State Foreign Corporation Laws As a Bar to Federal Diversity Jurisdiction*, 12 WM. & MARY L. REV. 416, 428 (1970).

<sup>31</sup> *Emulsol Corp. v. Rubenstein & Son Produce, Inc.*, 111 F. Supp. 410, 411 (N.D. Tex. 1953).

<sup>32</sup> *Waggener Paint Co. v. Paint Distrib., Inc.*, 228 F.2d 111, 113 (5th Cir. 1955).

<sup>33</sup> *Byrd v. Blue Ridge Elec. Coop., Inc.*, 356 U.S. 525, 538 (1958).

<sup>34</sup> *Id.* at 537-38.

<sup>35</sup> 349 F.2d 60 (4th Cir. 1965).

<sup>36</sup> *Id.* at 63-64.

<sup>37</sup> *Id.* at 65. For a discussion of the *Szantay* case, see Note, *supra* note 23.

federal rules as the necessary means to achieve uniform "housekeeping" in the federal courts.

In *Power City Communications, Inc. v. Calaveras Telephone Co.*<sup>38</sup> a federal district court in California analyzed the state statute to determine the policies behind its enactment. There the question was whether rule 17(b), regarding the capacity of a corporation to sue, was to control over conflicting California law. In answering the question, the court determined that the state purpose was to protect the public from actions brought by dishonest and incompetent contractors. Weighing this state purpose against rule 17(b), the court determined that the substantive nature of the state law rendered the federal rule inapplicable.<sup>39</sup> It would seem that the court construed the state statute as being sufficiently bound up with the substantive right or obligation at issue.<sup>40</sup>

### III. AVONDALE SHIPYARDS, INC. v. PROPULSION SYSTEMS, INC.

Relying on *Woods*, the plaintiff in *Avondale* attempted to show the court that *Hanna*, and its adherence to the purpose of the federal rules, was not intended to control over regulations governing state public policy. The defendant, however, attacked the state statute as one lacking the substantive nature required to cause the dictates of *Woods* to control.

In determining the purpose of the state statute, the court seems to have implemented the test offered by *Szantay*.<sup>41</sup> The court took a careful look at the state policies underlying the California statute involved in the *Power City* decision and distinguished them from the policies underlying the statute in the case before it. The court distinguished the California statute from the Louisiana statute in that under the latter a foreign corporation may at any time register and subsequently be qualified to bring suit. The court further contrasted the California rule as one affecting substantive rights of litigants with the Louisiana rule which evidenced only a "conditional prohibition designed for 'housekeeping' purposes."<sup>42</sup>

The court went on to distinguish the purposes of rule 17(b) from those of rule 13(a). Rule 17(b) concerning capacity was said to be based on entirely different considerations from rule 13(a) which governs compulsory counterclaims.<sup>43</sup> Under rule 17(b) the capacity of a corporation to sue or be sued in any federal court is to be determined by the law of the state of its incorporation. But *Angel v. Bullington*<sup>44</sup> qualified the federal rule by holding that though the corporation may technically have capacity under rule 17(b), it cannot recover when recovery would not be possible in the state court.<sup>45</sup> In essence, the jurisdiction of the federal courts may not originally be invoked if the corporation lacks the capacity to sue in the forum state. As a contrary proposition, rule 13(a) counterclaims are not presented until after jurisdiction

<sup>38</sup> 280 F. Supp. 808 (E.D. Cal. 1968); see Kennedy, *Federal Civil Rule 17(b) and (c): Qualifying To Litigate in Federal Court*, 43 NOTRE DAME LAW. 273 (1968).

<sup>39</sup> 280 F. Supp. at 812.

<sup>40</sup> See note 36 *supra*, and accompanying text.

<sup>41</sup> *Id.*

<sup>42</sup> 53 F.R.D. at 348.

<sup>43</sup> *Id.* at 347.

<sup>44</sup> See note 8 *supra*.

<sup>45</sup> 330 U.S. at 190.

is demonstrated by the original claimant. At the time the counterclaim is asserted, the federal court has already obtained the necessary jurisdiction to invoke the power of the federal rules in governing procedural matters. While rule 17(b) must bow to forum state substantive rights, the court considered rule 13(a) as dominant over conflicting state law because of its inherently procedural nature.<sup>46</sup>

In using the blanket protection offered by *Hanna*, the court silently acknowledged the fact that only when a state statute failed to meet the test of *Byrd* and *Szantay* may it be disregarded in favor of the federal rules. Buttressing its position that rule 13(a) must control, the court cited the Fourth Circuit decision in *Tolson v. Hodge*.<sup>47</sup> The *Tolson* court held that "once a district court properly exercises jurisdiction to determine a cause of action, such procedural matters as the assertion of counterclaims should be governed by the specific Federal Rules pertaining thereto without further reference to state law."<sup>48</sup>

Apparently, the *Avondale* court is saying that because of the "housekeeping" purpose of the Louisiana statute, it would not control over either rule 13(a) or rule 17(b), thus making the Louisiana statute totally ineffectual in any federal action.<sup>49</sup> The court's use of the federal rules here, though valid in its premise, seemingly invalidates the Louisiana statute without subjecting it to constitutional scrutiny. The constitutionality of state foreign corporation laws has been questioned.<sup>50</sup> The vigorous dissent of Justice Jackson in *Woods* hinted that the "harsh, capricious, and vindictive"<sup>51</sup> nature of such statutes bordered on the unconstitutional.<sup>52</sup> If the court chose *Hanna* in order to avoid determination of the constitutionality of such statutes, it did so artfully. Any constitutional implications can now be avoided by using the approach of the court in *Avondale*. Although the court considers the dictates of *Hanna* to afford relief to corporations in such instances, it appears that use of *Hanna* in this area has become a technique designed to forestall answering the constitutional questions presented by state foreign corporation laws.

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<sup>46</sup> 53 F.R.D. at 346.

<sup>47</sup> 411 F.2d 123 (4th Cir. 1969).

<sup>48</sup> *Id.* at 127.

<sup>49</sup> In light of the broad language of the Louisiana statute, one may question whether the distinction between rule 17(b) and rule 13(a) situations drawn by some of the cases is valid. See notes 39, 45, 48 *supra*, and accompanying text. Although the transparent purpose of statutes such as these is to keep unregistered (and thus non-taxed) foreign corporations out of the regulating state's courts, the court in *Avondale* construes this Louisiana statute as a mere "housekeeping" rule. It is well settled that federal housekeeping rules prevail in federal courts. Since the Louisiana statute contains the broadest language possible, it is hard to conceive of any state's statute which would not be so construed by a court taking this approach. The state policy is the same for either claim or counterclaim. The *Avondale* reasoning would, therefore, appear to require the same result for either rule 17(b) or rule 13(a).

<sup>50</sup> See Note, *supra* note 30.

<sup>51</sup> 337 U.S. at 538, 539.

<sup>52</sup> A long line of Supreme Court decisions has held that a state statute must bear a reasonable relationship to the evils it seeks to prevent. *Southern Pac. Co. v. Arizona*, 325 U.S. 761 (1945). If this evil is a corporate avoidance of state taxes, the denial of a state forum as punishment seems inappropriate.

It has been convincingly argued that state foreign corporation laws place an unreasonable and, thus, unconstitutional burden on interstate commerce. Walker, *supra* note 23, at 750-56. The importance of discerning the state policy under the law in determining its burden on interstate commerce is discussed in Note, *Foreign Corporations: The Interrelation of Jurisdiction and Qualification*, 33 IND. L.J. 358, 367 (1958).