Another Fissure In The Internal Affairs Doctrine?

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In this post from last November, I mentioned two New Jersey decisions applying New Jersey law rather than the law of the state of incorporation. *Krzastek v. Global Resource Industrial & Power, Inc.*, No. A-1815-06T2 (N.J. Super. Ct. App. Div. Sept. 11, 2008) and *Conway v. DialAmerica Marketing, Inc.*, No. BER-C-116-08 (N.J. Super. Ct. Ch. Div. Sept. 30, 2008). Last December, Judge Thomas Griesa of the U.S. District Court for the Southern District of New York has ruled that New York law should be applied to a corporation's claim for constructive fraud and the remedy of forfeiture of compensation against a former corporate officer. *Tyco Int'l, Ltd. v. Kozlowski*, Case No. 02 Civ 7317 (TPG) (Dec. 1, 2010).

Dennis Kozlowski had been the Chief Executive Officer and Chairman of the Board of Tyco International, Ltd. before his conviction in New York state court on 22 counts of a 23 count indictment. He demanded that Tyco pay him over $100 million pursuant to various deferred compensation agreements. He also sought indemnity pursuant to the corporate bylaws. Not surprisingly, Tyco refused and filed suit in federal district court. Among other things, Tyco asserted a claim for constructive fraud and sought forfeiture of compensation as a remedy.

Mr. Kozlowski argued that Bermuda law, the jurisdiction of Tyco's incorporation, does not recognize either constructive fraud or forfeiture of compensation. Kozlowski relied heavily on the internal affairs doctrine to support his argument that Bermuda law should govern.[1] Judge Griesa, however, observed that New York "takes a much narrower view of the internal affairs doctrine than do some other jurisdictions." In his view, the internal affairs doctrine is only one factor used by New York courts in the traditional conflict of laws determination of which state has the greatest interest in the issue. Judge Griesa found that New York had the greatest because it was "the central place of the wrongful conduct". Judge Griesa's decision is further evidence that courts outside of Delaware will not slavishly bow before the internal affairs doctrine.

In California, Corporations Code § 2116 is often described as codifying the internal affairs doctrine. *Friese v. Superior Court,* 134 Cal. App. 4th 693, 706 (2005). That statute provides:

> *The directors of a foreign corporation transacting intrastate business are liable to the corporation, its shareholders, creditors, receiver, liquidator or trustee in bankruptcy for the making of unauthorized dividends, purchase of shares or distribution of assets or false certificates, reports or public notices or other violation of*

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official duty according to any applicable laws of the state or place of incorporation or organization, whether committed or done in this state or elsewhere. Such liability may be enforced in the courts of this state.

Note, however, that Section 2116 refers only to directors, not to officers, a detail overlooked by the Court of Appeal in *Friese.* *See* my article, "California Appellate Court Holds that the Internal Affairs Doctrine Does Not Trump California's Insider Trading Law" 2o Insights 15, 17 (2006).

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[1] The internal affairs doctrine generally requires that the internal affairs of a corporation be governed by the jurisdiction of incorporation.

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