Federal Law Governs a Foreign Corporation's Presence in a State in a Diversity Action
RECENT DEVELOPMENTS

FEDERAL LAW GOVERNS A FOREIGN CORPORATION'S PRESENCE IN A STATE IN A DIVERSITY ACTION

Jafitex Corp. v. Randolph Mills, Inc.
282 F.2d 508 (2d Cir. 1960)

Plaintiff commenced an action in a federal district court in New York based on diversity of citizenship against two New York corporations to recover for personal injuries. One defendant sought to implead a North Carolina corporation as a third-party defendant. Process against the North Carolina corporation was served in New York on a New York corporation acting as a selling agent in New York for the North Carolina corporation. The federal district court granted a motion to vacate service on the ground that the North Carolina corporation was not present in the forum under New York law. The court of appeals in reversing held that the determination of a foreign corporation's presence in a district, for purposes of service of process, is a procedural matter and accordingly must be determined by the federal standard.

In order to obtain a valid judgment, a court must have jurisdiction over the person of the defendant.1 Unless otherwise provided by Congress, personal jurisdiction is obtained by service of process in the state in which the federal court is sitting.2 Accordingly, a corporation must be present, i.e., doing business, in the state amenable to process.3 Since a corporation is an abstraction, numerous tests have been developed to determine when a corporation is "present" in a state.4

A recurrent problem in federal diversity litigation has been that of determining whether a federal court is bound by the state standard with respect to presence of a corporation when the state standard is more restrictive that the federal standard. Neither courts5 nor commentators6 are in agreement.

---

4 For a discussion of "doing business" tests, see Note, 21 Ohio St. L.J. 126 (1960).
5 For a lengthy discussion and citation of cases, see Kenny v. Alaska Airlines, Inc., 132 F. Supp. 838 (S.D. Cal. 1955); Note, 40 Minn. L. Rev. 715 (1956).
The federal courts have, generally, taken one of two approaches. First, some courts rely on Rule 4(d)(7) of the Federal Rules of Civil Procedure which provides that service may also be made "... in the manner prescribed by the law of the state ...". This language is said to include the state’s concept of "doing business." Thus, in Pulson v. American Rolling Mill Co. a two step analysis was used: (1) Did the state provide for bringing the corporation into its courts? (2) Was this within due process limitations? At the same time, it seems clear that Rule 4(d)(7) deals with only the manner or mechanical aspects of service on corporate defendants and does not deal with their amenability to process.

The courts using the second approach invoke the familiar procedural-substantive dichotomy of Erie R.R. v. Tompkins. The courts in this category, which hold that state law governs a corporation’s amenability to process, rigidly apply the outcome-determinative test of Guaranty Trust Co. v. York. The result is that if the corporation is not amenable to service from a state court, it is likewise not amenable to service from a federal court sitting in the same state. Some courts avoid such rigid ap-
application of the outcome-determinative test and hold this matter is procedural for the purposes of *Erie*.\(^\text{16}\)

The Supreme Court has not passed squarely on the application of the *Erie* principle to this problem. However, some indications of the scope of the *Erie* doctrine are apparent. To avoid a conceptual application of *Erie* the Supreme Court held that state practice must be followed where it will substantially affect the outcome of the litigation.\(^\text{17}\) The outcome test has been applied even as to form and mode of litigation.\(^\text{18}\) In *Angel v. Bullington*,\(^\text{19}\) a case involving a state statute forbidding a claim for deficiency judgment in a mortgage foreclosure action, the Court held that federal courts must follow state practice. A similar result was reached in *Woods v. Interstate Realty Co.*,\(^\text{20}\) where the statute required that a corporation register with the state as a prerequisite to bringing an action. In both *Angel* and *Woods*, permitting the actions to be maintained in a federal forum would have thwarted declared state policies.

The court in the principal case relied on *Byrd v. Blue Ridge Rural Electric Co-op.*,\(^\text{21}\) where the federal procedure of jury determination of a factual question was followed in the face of a state workmen’s compensation statute which allocated this function to the judge. *Byrd* appears to modify the outcome-determinative test used under *Erie* insofar as it says:

> Were outcome the only consideration a strong case might appear for saying the federal courts should follow state practice. But there are affirmative countervailing considerations . . . . The federal system is an independent system for administering justice to litigants who properly invoke its jurisdiction . . . . The policy of uniform enforcement of state-created rights and obligations cannot in every case exact compliance with a state rule— not bound up with rights and obligations . . . .


\(^{19}\) 330 U.S. 183 (1947).


\(^{21}\) 356 U.S. 525 (1957).

\(^{22}\) *Id.* at 537,
Thus, the court appears to suggest that an interest-weighing test\textsuperscript{23} be used in this "gray zone" between substance and procedure.

The counterbalancing consideration here is the desirability of permitting the federal system to establish its own jurisdictional requirements.\textsuperscript{24} The policy of \textit{Erie}, which is to achieve uniformity of result between federal and state courts sitting in the same state,\textsuperscript{25} cannot be seriously offended by making the "doing business" requirement procedural. At the same time, uniformity in the operation of federal courts would be promoted.

The interest to be considered on the opposite side is the state policy underlying the state rule and its relation to the \textit{Erie} rule. The state standard of "doing business" is not bound up with the cause of action; the existence of the cause of action still depends on the law of the state. The court in the instant case indicated that the only result of using the outcome test is to force the action into a North Carolina federal court and thus, to deny the litigants the procedural advantage of third-party practice available in federal diversity actions. Since the decision of \textit{International Shoe Co. v. Washington}\textsuperscript{26} many courts have broadened their "doing business" concept.\textsuperscript{27} This would indicate that there is no restrictive policy in many states. However, if there were a "door-closing" statute it could represent

\textsuperscript{23} The concurring opinion in the principal case suggests that the \textit{Byrd} case was based on the seventh amendment and thus not applicable to any other situation. \textit{But see, "The Supreme Court, 1957 Term," 72 Harv. L. Rev. 77, 147-50 (1958). See also, Hill, "The Erie Doctrine and the Constitution," 53 Nw. U.L. Rev. 541, 601-09 (1958).}

\textsuperscript{24} Barrows S.S. Co. v. Kane, \textit{supra} note 3 at 100-11; Partin v. Michaels Bronze Co. (concurring opinion), \textit{supra} note 14. Mr. Justice Rutledge dissenting in Cohen v. Beneficial Indust. Loan Co., 337 U.S. 541, 559 (1949), was the first to suggest an interest-weighing test. \"...[T]he real question is not whether the separation [substance-procedure] shall be made but how it shall be made: whether mechanically by reference to whether the state's courts' doors are open or closed, or by a consideration of the policies of \textit{Erie} with Congress' power to govern the incidents of litigation in diversity suits.\"


\textsuperscript{26} 326 U.S. 310 (1945). In this case the Supreme Court held that the fourteenth amendment required that state jurisdiction be asserted only over those foreign corporations which have certain minimum contacts with the forum so that "the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'"

\textsuperscript{27} See, State v. Harrison, 74 So. 2d. 371 (Fla. 1954); Schilling v. Roux Distilling Co., 240 Minn. 71, 59 N.W.2d 907 (1953), Davis-Wood Lumber Co. v. Ladner, 210 Miss. 863, 50 So. 2d 615 (1951); Wooster v. Tremont Mfg. Co., 356 Mo. 682, 203 S.W.2d 411 (1947); Grace v. Proctor & Gamble Co., 95 N.H. 74, 57 A.2d 619 (1948).

In Perkins v. Benque Consol. Mining Co., 342 U.S. 437 (1952), the Supreme Court, finding that a dismissal by the Supreme Court of Ohio was based on constitutional fears, held that jurisdiction could be maintained without violating due process. On remand, 158 Ohio St. 145, 107 N.E.2d 203 (1952), the Ohio Supreme Court, sustained jurisdiction stating that there was general agreement that jurisdiction might
a legitimate state policy and thus govern diversity actions in federal court.\textsuperscript{28} The considerations of effective judicial administration are clearly more weighty and suggest that the question of a foreign corporation's presence to permit service of process be declared a procedural matter within the \textit{Erie} dichotomy. Moreover, it would seem that litigants having access to the federal court system on the ground of diversity of citizenship should be entitled to the essentials of a trial according to federal standards.\textsuperscript{29}

The main point of conflict between the majority and the concurring opinion in the principal case is the absence of legislative support for interpreting this as a procedural rule. It seems clear that Congress could make this a rule of procedure.\textsuperscript{30} However, it would also seem clear that the policy of \textit{Erie} could be undercut by either a statute or a judicial decision affecting matters outside the federal ambit.\textsuperscript{31}

The majority suggests that under a proper historical approach the "doing business" requirement has a statutory basis. "... [T]he federal principal of personal service in the district [now the state] goes back to the statute creating the federal courts [and] ... the mere fact that pre-\textit{Erie} cases have interpreted and defined the principle ... does not hide its statutory basis."\textsuperscript{32} Therefore, it is argued that this is a traditional federal practice and should be continued under \textit{Erie}.

The situation needs clarification, but above all, the extent of the \textit{Erie} doctrine must be resolved. Heretofore, the courts in dealing with this problem have not weighed the competing interests or viewed the problem in historical perspective. This case, then, should help in alleviating some of the confusion in this area of the law.

\textsuperscript{28} A state desiring to encourage foreign corporations who would do only a minimum of business to come into the state might do so by limiting their amenability to suit. Such a statute promoting a legitimate interest could represent a substantive policy protected by the \textit{Erie} principle.

\textsuperscript{29} See Barrow S.S. Co. v. Kane, \textit{supra} note 3, at 100-11; Partin v. Michael's Bronze Co. (concurring opinion), \textit{supra} note 14.


\textsuperscript{31} See generally, Hart, "The Relations Between State and Federal Law," 45 Colum. L. Rev. 489.

\textsuperscript{32} Jaftex Corp. v. Randolph Mills, Inc., 282 F.2d 508, 516 (2d Cir. 1960).