RECENT DEVELOPMENTS

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

Jaftex 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 courts[5] not commentators[6] are in agreement.

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[1] Pennoyer v. Neff, 95 U.S. (5 Otto) 714 (1877).

[2] Fed. R. Civ. P. 4(f).

[3] International Shoe Co. v. Wash., 326 U.S. 310 (1945); Bank of America v. Whitney Cent. Nat'l Bank, 261 U.S. 171 (1923); Philadelphia & R. R.R. v. McKibbin, 243 U.S. 264 (1917); *Cf.*, Dickinson Farm Mortgage Co. v. Harry, 273 U.S. 119 (1927); Barrow S.S. Co. v. Kane, 170 U.S. 100 (1897); 2 Moore, Federal Practice 969 (2d ed. 1948).

[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).

[6] *Compare* 1 Moore, Federal Practice ¶ 4.25 (2d ed. 1948) *with* 1 Barron & Holtzoff, Federal Practice and Procedure 605, 696 (Wright ed. 1960). See also Comment, 56 Colum. L. Rev. 394 (1956); Comment, 30 Ind. L.J. 324 (1955); Comment, 4 Wayne L. Rev. 164 (1958); Note, 5 Duke L.J. 129 (1956); Note, 69 Harv. L. Rev. 508 (1956); Note, 40 Minn. L. Rev. 715 (1956); Note, 34 St. John's L. Rev. 146 (1959); Note, 67 Yale L.J. 1094 (1958); Hart and Wechsler, The Federal Courts and the Federal System 960, 961 (1953).

The federal courts have, generally, taken one of two approaches.[7] First, some courts rely on Rule 4(d)(7) of the Federal Rules of Civil Procedure[8] which provides that service may *also* be made ". . . in the manner prescribed by the law of the state . . . ."[9] This language is said to include the state's concept of "doing business."[10] Thus, in *Pulson v. American Rolling Mill Co.*[11] 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.[12]

The courts using the second approach invoke the familiar procedural-substantive dichotomy of *Erie R.R. v. Tompkins*.[13] The courts in this category, which hold that state law governs a corporation's amenability to process,[14] rigidly apply the outcome-determinative test of *Guaranty Trust Co. v. York*.[15] 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-

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[7] A third approach is taken in Satterfield v. Lehigh Valley R.R., 128 F. Supp. 669, 670 (S.D.N.Y. 1955). This court relies on the "doing business" language on the venue statute, 28 U.S.C. § 1391(c)(1958), as equally applicable to service of process on a corporation. This is arguable under an historical approach since the venue and service of process requirements were treated together from the Judiciary Act of 1789, 1 Stat. 79, until the revision of the Judicial Code, 62 Stat. 869, in 1948 when the venue section went to 28 U.S.C. § 1391 and service to 28 U.S.C. § 1693. See Barrett, "Venue and Service of Process in the Federal Courts—Suggestions for Reform," 7 Vand. L. Rev. 608, 619 (1954); See also Hart & Wechsler, *op. cit. supra* note 6.

[8] Fed. R. Civ. P. 4(d)(7).

[9] *Ibid.*

[10] Pulson v. American Rolling Mill Co., 170 F.2d 193 (1st Cir. 1948); *Accord,* Stanga v. McCormick Shipping Corp., 268 F.2d 544 (5th Cir. 1959); Florio v. Power Tool Corp., 248 F.2d 367 (3d Cir. 1957); Robert v. Evans Case Co., 218 F.2d 893 (7th Cir. 1955); Electrical Equip. Co. v. Hamm Dragage Co., 217 F.2d 656 (8th Cir. 1954); Schmidt v. Esquire, Inc., 210 F.2d 908, 915 (7th Cir. 1954); Harris v. Deere & Co., 128 F. Supp. 799, 802 (E.D.N.C. 1955).

[11] 170 F.2d 193 (1st Cir. 1948).

[12] See Fed. R. Civ. P. 82; Barron & Hotzoff, Federal Practice and Procedure 318, 319 (Rule Ed. 1950); 2 Moore, Federal Practice 969, 970 (1948). See also Scholnik v. National Airlines, Inc., 219 F.2d 115, 120 (6th Cir. 1955); Gravely Motor Plow & Cultivator Co. v. Carter Co., 193 F.2d 158, 159 (9th Cir. 1951); see also Kenny v. Alaska Airlines, *supra* note 5, at 843.

[13] 304 U.S. 64 (1938).

[14] Smith v. Ford Gum & Mach. Co., 212 F.2d 581 (5th Cir. 1954); Robbins v. Benjamin Air Rifle Co., 209 F.2d 173 (5th Cir. 1954); Partin v. Michaels Bronze Co., 202 F.2d 541 (3d Cir. 1953); Canvas Fabricators, Inc. v. Hooper & Sons Co., 199 F.2d 485 (7th Cir. 1952); Steinway v. Majestic Amusement Co., 179 F.2d 681 (10th Cir. 1949); Jenkins v. Dell Publishing Co., 130 F. Supp. 104 (W.D. Pa. 1955); Kenny v. Alaska Airlines, Inc., *supra* note 5.

[15] 326 U.S. 99 (1945).

plication of the outcome-determinative test and hold this matter is procedural for the purposes of *Erie*.[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.[17] The outcome test has been applied even as to form and mode of litigation.[18] In *Angel v. Bullington*,[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.*[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.*[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 . . . .[22]

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[16] See, *e.g.*, Scholnik v. National Airlines, Inc., *supra* note 12; French v. Gibbs Corp., 189 F.2d 787 (2d Cir. 1951); Latimer v. S/A Industrias Reunidas F. Matarazzo, 175 F.2d 184 (2d Cir.), *cert. denied*, 338 U.S. 867 (1949); Echeverry v. Kellogg Switchboard & Supply Co., 175 F.2d 900 (2d Cir. 1949); Bach v. Friden Calculating Machine Co., 167 F.2d 679 (6th Cir. 1948); Lasky v. Norfolk & W. Ry., 157 F.2d 674 (6th Cir. 1946); Jacobowitz v. Tompson 141 F.2d 115 (2d Cir. 1944); General Elec. Co. v. Masters Mail Order Co., 122 F. Supp. 797 (S.D.N.Y. 1954); Ackerly v. Commercial Credit Co., 111 F. Supp. 92 (D.N.J. 1953); Pike v. New England Greyhound Lines, Inc., 93 F. Supp. 669 (D. Mass. 1950); *Cf.*, Sarpiro, Inc. v. New York Cent. R.R., 152 F. Supp. 722 (E.D. Mich. 1957), noted in 67 Yale L.J. 1094 (1958). This decision was based solely on Riverback Lab. v. Hardwood Prod. Corp., 350 U.S. 1003 (1956), in which the Supreme Court reversed (*per curiam*) the Seventh Circuit (220 F.2d 465), which had taken the view that state law governed. However, that opinion appears to be too brief to be conclusive. See Kurland, "Mr. Justice Frankfurter, The Supreme Court and the Erie Doctrine in Diversity Cases," 67 Yale L.J. 187, 211-12 (1957).

[17] Guaranty Trust Co. of New York v. York, 326 U.S. 99 (1945).

[18] Bernhardt v. Polygraphic Co., Inc., 350 U.S. 198 (1955).

[19] 330 U.S. 183 (1947).

[20] 337 U.S. 535 (1949).

[21] 356 U.S. 525 (1957).

[22] *Id.* at 537.

Thus, the court appears to suggest that an interest-weighing test[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.[24] The policy of *Erie,* which is to achieve uniformity of result between federal and state courts sitting in the same state,[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 *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 *International Shoe Co. v. Washington*[26] many courts have broadened their "doing business" concept.[27] This would indicate that there is no restrictive policy in many states. However, if there were a "door-closing" statute it could represent

[23] The concurring opinion in the principal case suggests that the *Byrd* case was based on the seventh amendment and thus not applicable to any other situation. *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).

[24] Barrows S.S. Co. v. Kane, *supra* note 3 at 100-11; Partin v. Michaels Bronze Co. (concurring opinion), *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 *Erie* with Congress' power to govern the incidents of litigation in diversity suits."

[25] Cohen v. Beneficial Indust. Loan Co., 337 U.S. 541, 556 (1949); Ragan v. Merchant's Transfer & Warehouse Co., 337 U.S. 530, 532 (1949); Woods v. Interstate Realty Co., 337 U.S. 535, 538 (1949); Guaranty Trust Co. of New York v. York, *supra* note 17, at 101-02.

[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.'"

[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. Benquet 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.[28]

The considerations of effective judical 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 *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.[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.[30] However, it would also seem clear that the policy of *Erie* could be undercut by either a statute or a judicial decision affecting matters outside the federal ambit.[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 gack to the statute creating the federal courts [and] . . . the mere fact that pre-*Erie* cases have interpreted and defined the principle . . . does not hide its statutory basis."[32] Therefore, it is argued that this is a traditional federal practice and should be continued under *Erie*.

The situation needs clarfication, but above all, the extent of the *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.

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be sustained in the present situation. *But see,* Pulson v. American Rolling Mill Co., *supra* note 10, at 195; Ackerly v. Commercial Credit Co., 111 F. Supp. 92, 98 (D.N.J. 1953).

The assumption in the principal case, and in other cases originating in federal court, is that *International Shoe* also expresses the federal test. *E.g.,* Latimer v. S/A Industrias Reunidas F. Matarazzo, *supra* note 16; Bach v. Friden Calculating Mach. Co., *supra* note 16; Clover Leaf Freight Lines, Inc. v. Pacific Coast Wholesalers Ass'n, 166 F.2d 626 (7th Cir.), *cert. denied,* 335 U.S. 823 (1947). Hanley Co. v. Buffalo Forge Co., 89 F. Supp. 246 (W.D. Pa. 1950); Smith v. Hall, 79 F. Supp. 473 (N.D. Tex. 1948).

[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 *Erie* principle.

[29] See Barrow S.S. Co. v. Kane, *supra* note 3, at 100-11; Partin v. Michael's Bronze Co. (concurring opinion), *supra* note 14.

[30] Iovino v. Waterson, 274 F.2d 41 (2d Cir. 1959), *cert. denied,* 362 U.S. 949 (1960); D'Onofrio Constr. Co. v. Recon Co., 255 F.2d 904 (1st Cir. 1958); Sampson v. Channell, 110 F.2d 754 (1st Cir.), *cert. denied,* 310 U.S. 650 (1940). *But cf.* Bernhardt v. Polygraphic Co., *supra* note 18. See also Hill, "The Erie Doctrine and the Constitution," 53 Nw. U.L. Rev. 436-37 (1958).

[31] See generally, Hart, "The Relations Between State and Federal Law," 45 Colum. L. Rev. 489.

[32] Jaftex Corp. v. Randolph Mills, Inc., 282 F.2d 508, 516 (2d Cir. 1960).