NEW YORK COURT OF APPEALS ROUNDUP

NY COURT REAFFIRMS INTERNAL AFFAIRS DOCTRINE FOR FOREIGN CORPORATIONS

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In *Ezrasons, Inc. v. Rudd*, the Court of Appeals affirmed New York's internal affairs doctrine, which holds that the rights and relationships of corporate shareholders and managers are presumptively governed by the law of the place of incorporation.

In a decision written by Judge Anthony Cannataro and joined by Judges Jenny Rivera, Madeline Singas, Shirley Troutman, Caitlin J. Halligan and Carl Landicino, the Court of Appeals held that New York's Business Corporation Law (BCL) did not alter the internal affairs doctrine that has long been part of New York's common law.

In a vigorous dissent, Chief Judge Rowan D. Wilson argued that the BCL displaced the internal affairs doctrine to provide plaintiffs standing to bring derivative actions that they might not otherwise have under the law of the place of incorporation. Judge Michael J. Garcia took no part in the proceedings.

The case concerned a shareholder derivative complaint alleging breaches of fiduciary duty by directors and officers of Barclays Capital Inc., a bank holding company incorporated under the laws of England and Wales.

Barclays, a nominal defendant, as well as certain of the officer and director defendants moved to dismiss on the basis that plaintiff lacked standing under English law.

Defendants argued that under English law, derivative actions may be brought only by registered members of the corporation, and plaintiff was not a registered member.

Plaintiff argued its suit was authorized by Sections 626(a) and 1319(a)(1) of the BCL, which permit derivative suits by shareholders regardless of whether they are registered.

Section 626(a) provides "[a]n action may be brought in the right of a domestic or foreign corporation to procure a judgment in its favor, by a holder of shares or of voting trust certificates of the corporation or of a beneficial interest in such shares or certificates."

Section 1319(a)(2) provides that Section 626 (among others), "to the extent provided therein, shall apply to a foreign corporation doing business in this state, its directors, officers and shareholders."

Plaintiff argued that because Barclays does business in New York, derivative actions may be brought against Barclays so long as they are compliant with Section 626, regardless of whether such actions may comply with English law.

The Supreme Court, New York County granted defendants' motion to dismiss on the basis that BCL Sections 626 and 1319 provide New York courts with jurisdiction to hear derivative suits on behalf of out-of-state corporations, but do not supplant the out-of-state law that would otherwise apply to such suits

under the internal affairs doctrine. *Ezrasons, Inc. v. Rudd*, 2022 WL 20476314 (Sup. Ct. N.Y. Cnty. May 4, 2022).

The Appellate Division, First Department affirmed, 191 N.Y.S.3d 349 (2023), and the Court of Appeals granted plaintiff's motion for leave to appeal. 41 N.Y.3d 903 (2024).

The Court of Appeals found that the internal affairs doctrine extends back to the mid-nineteenth century and that, while the doctrine initially provided a basis for courts to decline jurisdiction over disputes regarding the internal affairs of out-of-state corporations, the doctrine evolved into a choice-of-law rule.

By favoring the state of incorporation's substantive law, the doctrine is designed to ensure corporations are not faced with conflicting demands regarding the conduct of their internal affairs and thus serves the interests of predictability and consistency.

The majority noted that as a common law rule the internal affairs doctrine may be altered by statute, but "the intention to change a long-established [common-law] rule or principle is not to be imputed to the legislature in the absence of a clear manifestation." The majority found no such clear manifestation in the text of the BCL.

Rather, BCL Section 626 simply confirms New York courts' jurisdiction to hear derivative suits brought on behalf of out-of-state corporations.

The majority also reviewed the legislative history regarding Sections 626 and 1319, and found no clear indication that the legislature intended to displace the internal affairs doctrine.

In his dissent, Wilson argued that the court need not find a "clear manifestation" in the BCL to displace the common law, because prior to 1961 (when the BCL was enacted) the internal affairs doctrine was not a choice-of-law rule.

Rather, Wilson read the pre-1961 cases as holding only that New York's courts had discretion to decline jurisdiction over cases involving foreign corporations.

Wilson ended BCL Section 626 as a choice-of-law provision to apply to out-of-state corporations.

His dissent noted that as of 1961, New York's dominance as a commercial center was unparalleled such that it would be natural for the legislature to provide for New York law to apply even to non-New York corporations.

In view of the majority, however, the dissent's interpretation of the case law was "off base" and its historical analysis "idiosyncratic."

The majority declined to overrule "a painstakingly developed body of law and decades worth of settled expectations based on one vague statutory sentence and equivocal legislative history."

The internal affairs doctrine accordingly continues to be the law of the state. However, attempts by plaintiffs to plead derivative claims in New York against foreign corporations that might not be cognizable in the place of incorporation will continue.

The Court of Appeals recently held in *Eccles v. Shamrock Capital Advisors, LLC*, 42 N.Y.3d 321, 339 (2024), that the presumption under the internal affairs doctrine that the place of incorporation's law will apply could be rebutted by showing that (1) the interest of the place of incorporation is minimal and (2) New York has a dominant interest in applying its own substantive law.

The plaintiff in *Ezrasons* did argue that the English requirement that a shareholder bringing a derivative claim be registered should not apply because it is an English procedural requirement, rather than substantive law, and thus would not be applicable in New York even under the internal affairs doctrine.

The Court of Appeals, however, found this argument had not been preserved below.

This leaves room for future litigation over whether foreign or out-of-state requirements for pleading derivative claims are substantive—and therefore presumptively applicable under the internal affairs doctrine—or procedural requirements that would not apply in New York.

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