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Client Alert | Corporate & Securities

Door-Closing Statutes: Which Activities Require Registration/Qualification as a Foreign Entity?

Corporations, limited liability companies and other entities must be formed under the laws of a specific state, but the ability of those entities to act does not stop at the state border. Door-closing statutes address the circumstances under which an entity that is doing business in a state other than its state of formation must register or qualify to do business as a foreign entity in that other state (i.e., the foreign jurisdiction). The term "door-closing statute" refers to the fact that the principal consequence of doing business in a foreign jurisdiction where an entity has failed to qualify is that the entity will not be permitted to maintain a lawsuit in the courts of the foreign jurisdiction.

Qualification requirements are straightforward in principle. In practice, however, it can be difficult to determine whether an entity is doing business in a manner that requires registration. The explosion of remote work in recent years has made this analysis even more challenging, as employees are increasingly working in foreign jurisdictions where the employing entity does not have an office.

Many door-closing statutes are based on [Chapter 15 of the Model Business Corporation Act] (MBCA) published by the American Bar Association Business Law Section's Corporate Laws Committee, but even door-closing statutes that are not based on the MBCA tend to have similar provisions. All state door-closing statutes are subject to federal constitutional principles that influence the scope of state authority to govern the activities of foreign entities within their borders. Although we examine Article 13 of the [New York Business Corporation Law] (NY BCL) as an example of a typical door-closing statute, the application of a door-closing statute depends on the state in which it was adopted as well as the type of entity to which it applies, so counsel should always consider the specifics of the situation.

New York's Corporate Door-Closing Statute

Section 1301(a) of the NY BCL provides, in part: "A foreign corporation shall not do business in this state until it has been authorized to do so as provided in this article." As used in this statute, a "foreign corporation" is defined as a for-profit corporation that was incorporated under the laws of a jurisdiction other than New York state.

Certain portions of New York's door-closing statute are fairly straightforward. Section 1304 of the NY BCL clearly sets out the requirements for a foreign corporation's submission of an application for authority to do business in New York state. Section 1305 of the NY BCL specifies that the authority of the foreign corporation continues from the filing of the application for

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authority by the New York State Department of State until the earlier of (1) such time as the corporation ceases to have authority to do business in its jurisdiction of incorporation or (2) until the corporation's authority to do business in New York is surrendered, suspended or annulled in accordance with law. Section 1312(a) of the NY BCL makes clear that a foreign corporation doing business in New York may not maintain any action or special proceeding unless and until the corporation qualifies and has paid all New York fees and taxes accrued against the corporation, including any penalties and interest. Section 1312(b) of the NY BCL confirms that the failure of a foreign corporation to qualify in New York does not impair the validity of the corporation's contracts, nor does it prevent the foreign corporation from defending itself in any action brought against the corporation in a New York court. Unfortunately, this clarity does not extend to the central question of which activities constitute "doing business" and thus require registration under the NY BCL.

Actions That Constitute 'Doing Business' Under Door-Closing Statutes

Door-closing statutes do not attempt to define the activities that require registration beyond the vague term "doing business," so the determination of whether an entity must register under a door-closing statute can be complex. But certain general principles apply to the analysis, which must be performed on a case-by-case basis for each factual situation.

Distinguish 'Doing Business' for Purposes of Jurisdiction and Taxation

The concept of "doing business" is used in the law for at least three distinct purposes: (1) to determine whether a court can exercise long-arm jurisdiction over a party in a given case; (2) to determine whether a party can be taxed in a given jurisdiction; and (3) to determine whether an entity can be required to register as a foreign corporation in a given state. Since long-arm jurisdiction and taxation are linked to specific contacts between the party and the state, the level of contact needed to support long-arm jurisdiction or taxation is generally less than the level of contact needed to trigger a registration requirement under a door-closing statute.

Door-Closing Statutes Exclude Certain Activities from 'Doing Business'

When determining whether a foreign entity's activities in a state will trigger a registration requirement, it is always advisable to begin with the words of the statute that applies to the specific entity type and the specific state at issue. Most door-closing statutes include a limited, non-exclusive list of activities that are expressly excluded from the scope of the statute and do not trigger the registration requirement.

Section 1301(b) of the NY BCL provides the following list of activities that do not constitute "doing business" for purposes of New York's corporate door-closing statute: (1) maintaining, defending or settling any action, proceeding or claim; (2) holding meetings of the corporation's directors or shareholders; (3) maintaining bank accounts; and (4) maintaining transfer agents, trustees or depositaries with relation to the corporation's securities. New York is not alone in exempting these activities from its door-closing statute. Other activities that may be excluded from door-closing statutes include carrying on internal corporate affairs, selling through independent contractors, soliciting orders by mail, creating or acquiring indebtedness, securing or collecting debts, or owning real or personal property.[1] When determining whether qualification is required, a review of the applicable statute is an important first step.

[1] Recent amendments to the Uniform Law Commission's Unincorporated Organization Acts' foreign registration exclusions include additional clarifications and also adopt the "current exigency" policy. One addition involves the acquiring, owning, holding, leasing, conveying and transferring (1) real estate, mortgages and other related liens; or (2) personal property and related security interests. Another addition excludes from the foreign registration requirement conducting operations or performing work or services in good faith in response to a disaster or emergency event.

Require Substantial, Permanent, Continuous and Regular Activity in the State
Unlike long-arm jurisdiction or taxation, which may be based on an isolated transaction or minimal contacts with a state, “doing business” for purposes of door-closing statutes requires a significant level of activity in the foreign jurisdiction. As described by New York courts, to trigger the registration requirement in Section 1301 of the NY BCL, the intrastate activity must be substantial, permanent, continuous and regular. In other words, the corporation must have localized a portion of its business activity in the state. (See, e.g., *Parkwood Furniture v. OK Furniture*, 76 A.D.2d 905 (2d Dept. 1980).)

Neither the dollar value of an entity’s transactions in a state nor the number of those transactions is determinative for the purpose of deciding whether the entity is “doing business” within the meaning of a door-closing statute. Rather, courts will engage in a fact-specific inquiry that looks at all of the entity’s activities to make its determination. Does the entity have an office and/or employees in the state? If so, are the employees engaging directly with customers in the state, or are the employees performing back-office or administrative functions? Does the entity have in-state employees who provide services to in-state customers, or does the entity provide such services indirectly through independent contractors? Does the entity maintain inventory in the state that is sold to its in-state customers? These and many other factors may be examined by courts when deciding whether an entity has contacts with a state that are sufficiently substantial, permanent, continuous and regular to justify a requirement that the entity register to do business in that foreign jurisdiction.

Activities Must Be Intrastate Commerce Rather Than Interstate Commerce
Under the Commerce Clause in Article I, Section 8, Clause 3 of the U.S. Constitution, Congress has the exclusive power to regulate interstate commerce. Accordingly, states are not permitted to burden interstate commerce by requiring that entities formed in other states register to do business there based on activities that constitute interstate — as opposed to intrastate — commerce.

Many activities that, at first blush, would appear to be “doing business” in a state in fact constitute interstate commerce and would not require the entity to register. These include the quintessential business activities of soliciting orders, making sales and delivering goods. If employees must have customer contracts approved and signed at an office in the entity’s home jurisdiction, then even establishing a sales office and employing sales workers in a foreign jurisdiction would constitute interstate (rather than intrastate) commerce. Similarly, if inventory is held in another state and only shipped into the state upon customers’ purchases, the deliveries would be activities in interstate commerce and should not be considered when determining if the foreign entity must qualify in the state.

The case of *Invacare v. John Nageldinger & Son*, 576 F.Supp. 1542 (E.D.N.Y 1984), illustrates how the distinction between interstate and intrastate commerce can determine whether registration is required under a door-closing statute. The plaintiff, Invacare Corp., an Ohio corporation, sold medical goods to defendant John Nageldinger & Son Inc., a New York corporation. When the defendant failed to pay, the plaintiff sued in New York to recover the purchase price, but the defendant moved to dismiss the case on the grounds that the plaintiff was precluded from suing under New York’s door-closing statute. The court succinctly summarized the factual analysis as follows:

> In support of its contention that the Invacare Corporation is doing business under BCL § 1312(a), defendant points to the following factors: (1) plaintiff maintains five full time sales representatives and a sales manager who solicit sales in New

> York; (2) plaintiff derived gross sales of over $1 million in New York in 1980, over $2 million in 1981, and over $3 million in 1982; (3) plaintiff's representatives attended trade shows in New York; and (4) plaintiff has a network of over 500 customers throughout the State of New York. In response, plaintiff asserts that: (1) plaintiff's only business activity in New York is the mere solicitation of sales in interstate commerce; (2) the salesmen who solicit sales from New York must forward orders to Elyria, Ohio for acceptance and processing; (3) there are no sales offices or sales outlets in New York; (4) salesmen have toll free "800" telephone numbers on the business cards that are answered in Ohio; (5) there are no warehouses or stock of goods in New York; (6) there are no repair facilities in New York; and (7) plaintiff maintains no bank accounts in New York.

The court concluded that the plaintiff's activities constitute the interstate solicitation of sales in New York and corresponding deliveries. Since those activities in interstate commerce are not subject to New York's door-closing statute, the defendant's motion to dismiss was denied.

Failure to Be Qualified Is an Affirmative Defense
It is significant that door-closing statutes prohibit unregistered foreign entities from "maintaining" an action or proceeding. The statutes do not prohibit unregistered foreign entities from filing claims or otherwise commencing proceedings. Rather, the foreign entity's failure to be qualified constitutes a lack of capacity to sue that must be raised by the defendant as an affirmative defense. If the defendant fails to raise the defense, it will be waived. Perhaps more importantly, if the foreign entity registers with the state before the case is dismissed, then the lack of capacity will be cured, and the case will no longer be subject to dismissal under the door-closing statute. This is true even if the foreign entity's qualification is filed with the state after the foreign entity files the complaint in the case.

Of course, a foreign entity that has been doing intrastate business in a state without being registered may have to pay substantial penalties and interest to the state in order for its qualification to be filed. Some states may impose additional penalties or burdens on a foreign entity that seeks to register after having done business as an unregistered foreign entity for a period of time. Notably, Section 1304(a)(8) of the NY BCL requires that a foreign corporation seeking to register to do business in New York either: (1) certify in its application for authority that the corporation has not engaged in any activity in New York except for the excluded activities previously described; or (2) attach to its application for authority a tax clearance certificate confirming that the corporation has paid all taxes that it owes to New York for prior periods. Because the process of obtaining tax clearance from the New York State Department of Taxation and Finance can take several months, this requirement could present a challenge to a corporation that seeks to cure its failure to register in New York before dismissal of its case against a defendant.

Takeaways

Determining whether an entity must qualify in a state other than its jurisdiction of formation is a fact-specific inquiry. The entity's intrastate activities — excluding its activities in interstate commerce and any other activities excluded by the applicable door-closing statute — must be substantial, permanent, continuous and regular.

The factual inquiry should consider activities such as the following:

Activity in the Foreign Jurisdiction	Registration May Be Required	Registration Likely Not Required
Maintains an office in the state.	X	
Maintains inventory in the state.	X	
Delivers products manufactured outside the state to in-state customers.		X
Solicits orders in the state for fulfillment from outside the state.		X
Employees in the state have regular contact with customers.	X	
Employees in the state perform services for customers, such as installation or repair services.	X	
Entity engages independent contractors to perform installation or repair services in the state.		X
Employees in the state have the authority to enter into contracts.	X	
Employees in the state must have contracts approved and signed at an office of the entity that is out of state.		X
Local telephone numbers and addresses are used for inquiries in the state.	X	
Phone numbers and contact addresses are out of state.		X
Intrastate activities are permanent, continuous and regular.	X	
Entity will engage in one or two isolated transactions in the state.		X

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