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# SPECIFIC “DOING BUSINESS” ACTIVITIES THAT AFFECT THE FOREIGN QUALIFICATION REQUIREMENT



**“In general, whether a foreign corporation’s activities are considered interstate or intrastate will be determined based on whether the Corporation has localized its business.”**

A corporation may jeopardize its ability to gain full access to the courts of a state (other than its state of incorporation) if it is found to be “doing business” in a foreign state without having qualified to do so. Consequently, its legal counsel needs a comprehensive understanding of which in-state activities constitute “doing business,” in order to protect the client’s legal rights.

## INTRODUCTION

The issue of whether a foreign corporation is required to qualify typically arises when that corporation attempts to bring a lawsuit in state courts. For example, the foreign corporation may be trying to enforce a contract. The defendant might claim that the plaintiff, as an unqualified foreign corporation, lacks the capacity to bring an action in the state court. The court must then decide if the foreign corporation was transacting intrastate business and whether qualification was required.

There is no settled definition of “doing business” for qualification purposes. However, one standard that courts will use holds that a foreign corporation is engaging in business within a state if a substantial part of its ordinary business is transacted there.

Decisions about qualification are made on a case-by-case basis. A court’s analysis will consider all relevant facts. While a particular act may not, alone, constitute doing business, the cumulative effect of a foreign corporation’s activities will generally determine if qualification is necessary.

## INTERSTATE AND FOREIGN COMMERCE VS. INTRASTATE COMMERCE

The Commerce Clause of the United States Constitution limits a state’s power to require a corporation to qualify. That clause grants Congress the exclusive power to regulate interstate commerce. Qualification statutes are regulatory. Therefore, they cannot be imposed on corporations engaged exclusively in interstate commerce. Most statutes reflect this limitation by including “transacting interstate commerce” as one of the activities a foreign corporation may engage in without having to qualify. Sec. 106 (1) of the Model Business Corporation Act and Sec. 15.01 (b)(ii) of the Revised Model Business Corporation Act include such a provision. Most states have adopted either the Model or Revised Model Act.

A state cannot deny an unqualified foreign corporation the right to sue on a transaction or contract that solely involves interstate commerce. In general, whether a foreign corporation’s activities are considered interstate or intrastate will be determined based on whether the

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corporation has localized its business. Factors that will influence this decision include, among many others, the quantity of business done in a state as well as the business’s permanence and number of employees and officers there.

The Constitution also grants Congress the power to regulate commerce with foreign nations. Consequently, a non-United States corporation engaged exclusively in foreign commerce cannot be forced to qualify in a state.

### ISOLATED TRANSACTIONS AND ACTIVITIES

Nearly every state provides that conducting an isolated transaction does not constitute transacting business in the state. Sec. 106(j) of the Model Business Corporation Act and Sec. 15.01(b)(10) of the Revised Model Act provide that a foreign corporation is not considered to be transacting business for an isolated act that occurs in a 30-day window and is not repeated. Most states have adopted one of these provisions. A few have a time limit other than 30 days.

Difficulties can arise when attempting to define “isolated.” In some cases, the courts have ruled that business activities such as advertising, contracting for services or renting office space indicate more than an isolated transaction. Fulfilling a limited number of contracts, but for a long duration, has also failed to pass the test of “isolated.”

A single contract is generally considered an isolated transaction. However, this may not be the case when the transaction is part of the foreign corporation’s ordinary business.

### CORPORATE SECONDARY ACTIVITIES

A secondary activity is one that does not further the corporation’s primary business purpose. It includes activities such as:

- ▶ Maintaining a bank account
- ▶ Carrying on activities related to internal affairs
- ▶ Acts conducted to determine whether to pursue business opportunities in a state
- ▶ Maintaining books and records and collecting accounts
- ▶ Maintaining and defending suits

Although a secondary activity may not require qualification in and of itself, the courts evaluate the totality of a foreign

corporation’s activities and a secondary activity could contribute to the need for qualification.

### HOLDING INTERESTS IN RESIDENT BUSINESSES

Various factors must be considered when determining if a foreign corporation is required to qualify in a state because of its relationship with another corporation or firm that is doing business in the state.



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**Franchise operations:** The degree of control that a foreign corporation holds over its franchised dealers generally determines if the corporation must qualify, and the courts typically look beyond the franchise agreement for evidence of control.

**Wholesaler-dealer relationships:** These typically do not require qualification because the foreign corporation has no control over the dealer. This may change, however, if the foreign corporation becomes more involved in the dealer’s operations or supervises its activities.

**Holding companies:** The states differ as to whether a foreign holding company must qualify. Some require qualification in the state where the company votes, holds meetings, directs its subsidiaries’ affairs and performs other acts necessary to function. Other states will allow some of these activities without requiring qualification.

**Parent and subsidiary corporations:** In general, a foreign parent corporation is not required to qualify in a state simply because its subsidiary is doing business there, and a foreign corporation is not held to be doing business in a state simply because it is the wholly owned subsidiary of a domestic corporation. Some states have statutes address this situation.

**Partnerships, LLCs and joint ventures:** Some states have statutes dealing with the question of whether acting as a partner, member of a limited liability company (LLC) or part of a joint venture constitutes doing business in the state where the partnership, LLC or joint venture is doing business. They differ as to whether qualification is required.

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## CONTRACTING AND CONSTRUCTION ACTIVITIES

Foreign corporations that construct, alter, remodel or repair structures are typically required to qualify. This is true because the work tends to be a substantial portion of their ordinary business and the nature of the activity is not consistent with interstate transactions.

The courts usually consider a variety of factors when determining if qualification is necessary including:

- ▶ Did the foreign corporation use local labor?
- ▶ Were the same services available from competing local contractors?
- ▶ How long did it take to fulfill the contract? (the longer the time, the more likely the foreign corporation will need to qualify)

**Federal contracts:** Qualification requirements for federal government projects are generally held to the same standard as general contracts. However, if the foreign corporation is performing work for the federal government in a federal area, the state’s right to require qualification will depend upon whether it has ceded its authority over the area to the federal government.

**Subcontracting:** In general, a primary contractor will be required to qualify if it actively supervises its subcontractors doing business in the states and bears the ultimate responsibility for the project. If the primary contractor performs some part of the contract, it will usually be required to qualify unless the work can be considered an isolated transaction or another statutory exemption applies. Subcontractors are typically held to the same rules as the primary contractor.

**Submitting bids:** Submitting a bid has been held to not constitute doing business.

## CREDIT ACTIVITIES

Sec. 106(h) of the Model Act states that a foreign corporation is not required to qualify to secure or collect debts or enforce any rights in property securing the same. The Revised Act, Sec. 15.01(b)(8) states that securing or collecting debts or enforcing mortgages and security interests in property securing the debts does not constitute doing business. The majority of states have adopted provisions that are substantially similar to these acts.

**Extending credit:** If a sale is an interstate transaction in all regards except for the fact that a note or mortgage was accepted for some or all of the payment, qualification will generally not be required.

**Lending money on security:** Sec. 106(g) of the Model Act and Sec. 15.01(b)(7) of the Revised Act provide that creating or acquiring indebtedness, mortgages or other security interests in property does not constitute doing business. These provisions have been adopted by most states. Some states have enacted separate statutory provisions of this nature to promote investment in their region.



“many states have made qualification mandatory by requiring it as part of the licensing process that all contractors must go through.”

## ENTERTAINMENT ACTIVITIES

**Broadcasting:** When broadcasting crosses state lines, it has been held as exempt from qualification under the interstate commerce exception.

**Professional sporting exhibitions and games:** Sporting events have been held to be local by their nature and therefore not necessarily exempt as being an interstate activity.

**Exhibition of films:** Whether qualification is required depends upon the specific facts. A foreign corporation involved in the exhibition of films in a local theater has been required to qualify, while a foreign corporation that manufactured and leased a film, but was not involved in exhibiting it, was not required to qualify.

**Production of films and shows:** Foreign corporations have been held to have to qualify where their productions represent a substantial portion of their ordinary business in a state and where the elements of interstate transactions are missing. However, a few states specifically exclude these activities if they last for only a certain period of time.

## LEASING ACTIVITIES

**Leasing personal property:** A foreign lessor typically does not have to qualify if there is out-of-state execution of the lease and limited oversight of the lessee. But if the lessor makes

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substantial notification or supervisory requirements of the lessee and/or performs additional services, this transaction might be considered intrastate business.

The length of the lease, in some cases, will impact decisions about qualification as will the number of leasing arrangements.

**Leasing real property:** A foreign corporation leasing real property to or from others has not been required to qualify where the transaction was isolated, was interstate in nature or was incidental or preliminary to doing business.

Qualification may be required however where the foreign corporation’s primary business is real estate or if the foreign corporation is carrying on additional activities or enters into a large number of leases.

### MANUFACTURING ACTIVITIES

The act of manufacturing goods or products in a state has been considered an intrastate activity. Foreign manufacturing corporations may therefore be required to qualify—even if a portion of their goods are sold through interstate commerce, their contracts are entered into in another state or their principal facility is in another state. It depends upon the extent of the in-state activities.

### PERFORMING SERVICES

The states differ in their views regarding providing services. Whether a foreign corporation is doing business is determined on a case-by-case basis by examining a number of factors.

**Installation of machinery and equipment:** When determining if a corporation must qualify if it installs machinery or equipment in a foreign state (in what would otherwise be considered an interstate sale), the key question is whether or not the installation was of a technical nature. For highly technical installations requiring specialized knowledge, the installation is usually held to be an integral part of the interstate sale and does not typically require qualification. In situations where the installation is not technical and the seller’s expertise is not required, qualification is generally determined to be necessary.

**Research work:** If a foreign corporation enters a state for the purpose of conducting research, it may be required to qualify if research work is a substantial part of its ordinary business. If the research work was a non-essential part of an otherwise interstate contract, qualification may not be required.

**Transportation companies:** Foreign corporations can generally transport people or goods, maintain offices and solicit orders without qualifying as long as their activities are strictly interstate or another exception applies.



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### PROPERTY OWNERSHIP AND RELATED ACTIVITIES

**Personal property ownership:** A number of states have statutes providing that mere ownership of personal property does not constitute doing business. If a foreign corporation does more than just hold property—for instance, engages in selling, shipping or maintaining and selling from a stock of in-state goods—it may be required to qualify.

**Processing:** When a foreign corporation sends raw materials to be processed in another state, which are then returned to the home state, the courts have had mixed views as to whether to consider this as doing business in the state.

**Purchasing:** Where a foreign corporation’s purchasing of materials or products was found to be an essential part of its in-state business, it was required to qualify.

Several decisions have suggested that if a foreign corporation’s only in-state activity is the purchase of goods or materials, and the main business of the corporation is conducted elsewhere, qualification is probably not required.

**Real property ownership:** Some states have a statute providing that real property ownership alone does not constitute doing business. In the absence of a state statute, the general rule is that a foreign corporation can acquire, hold and dispose of real property without qualifying. Qualification may be required if the foreign corporation engages in other local activities, engages in repeat real estate transactions or is organized for and engaged in the real estate business.

### SALES ACTIVITIES

**Sales of securities:** Because most corporate shares are sold through an underwriter, qualification is not usually an issue with these sales. In situations where a foreign corporation sells its own capital stock, most states do not require qualification.

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**Sales through brokers:** The courts have typically equated these sales to those through salesmen and have not required a foreign corporation to qualify as long as the elements of an interstate transaction are present.

**Shipments on consignment:** Generally, when a foreign corporation consigns goods to an independent dealer, the eventual sale is viewed as if it was made by the dealer. Qualification will usually be required if the consignee is the foreign corporation’s agent, operating under the corporation’s control and disposing of goods within the state. Also relevant are Sec. 106(e) of the Model Act and Sec. 15.01(b)(5) of the Revised Act, which provide that making sales through an independent dealer does not constitute doing business in a state.

**Solicitation:** Most states have a statute, many of which are based on Sec.106(f) of the Model Act or Sec. 15.01(b)(6) of the Revised Act, which provide that soliciting orders that require acceptance outside of the state before becoming binding contracts is not doing intrastate business.

Qualification might be required where solicitation is accompanied by other in-state activities such as taking orders, exerting control over the sales agent or product, shipping goods or advertising.

**Specialty salesmen:** This type of selling differs from direct sales in that the sales staff is working to promote orders from local dealers to the foreign corporation’s local wholesalers. In a U.S. Supreme Court case, a foreign corporation’s specialty sales staff was found to be conducting intrastate business even though all of its orders were subject to acceptance out of state, because, for all practical purposes, the foreign corporation was generating sales and conducting business in the foreign state.

**Subscription sales:** Selling merchandise on a continuing subscription basis can be deemed interstate business as long as the elements of interstate commerce are present. There

can be in-state solicitation of orders but acceptance of orders and delivery of product must come from outside of the state.

**Selling over the Internet:** To date there is little statutory or case law on this issue. Decisions are likely to be made on a case-by-case basis, with the courts focusing on the standard considerations of number of sales, percentage of sales, location of contract approval, etc. Physical presence is generally not required for a corporation to be considered to be doing business and the fact that a transaction occurs online does not transform it into an interstate operation. Statutory exemptions for isolated transactions and interstate commerce may also come into play.

### CONCLUSION

In order to ensure the full protection of state courts, it is critically important for legal counsel to understand and carefully analyze a client’s specific activities in a state. Whether a foreign corporation is doing business is determined by thoroughly examining its business purposes, its role in the transaction, where its actions were carried out, the amount of income derived from the activity, and a number of other factors.

For a more comprehensive discussion of Specific Doing Business Activities, including state-specific rulings and case law citations, please refer to CT Corporation’s 2016 version of *What Constitutes Doing Business: For Corporations Operating Outside Their State of Formation*.

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