

News & Types: Commercial, Competition & Trade Update

Warning to Corporate Plaintiffs: Beware of Suing in a State Where you are Not Qualified

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Practices: Commercial, Competition & Trade, Litigation

Corporations are created under state law. A corporation created under the law of one state can transact business in another (foreign) state, but only if it qualifies as a foreign corporation (sometimes referred to as obtaining a certificate of authority). Once it qualifies in the foreign state, it is treated just like any domestic corporation.

Historically, foreign corporations who entered into contracts in states where they were not qualified were treated harshly. One of the penalties imposed by a state was to make the contract void from the start (or void *ab initio*), which left the foreign corporation with no remedy, even on a meritorious claim. Almost every state now does not impose such a harsh penalty. Rather, states deprive the foreign corporation of the ability to "maintain" a suit in the state until it qualifies, thus permitting the foreign corporation to "cure" its inability to bring suit. Unqualified foreign corporations, faced with the inability to file suit, will almost inevitably simply qualify in the foreign state so that the foreign corporation can bring, or maintain, its suit. The ability to cure is so common and well established that it seldom arises in an appeal, since the foreign corporation will inevitably choose the easier course and qualify as a foreign corporation, rather than litigate whether it was required to qualify. But an recent interesting Illinois case, with an unusual set of facts, shows the issue may still arise. (*Young America's Foundation v. The Doris A. Pistole Revocable Living Trust, et. al.* Appellate Court of Illinois, 2nd District No. 2-12-1122, filed August 20, 2013)

Young America's Foundation (YAF) is a Tennessee not-for-profit foundation, with its main offices in Virginia and California. Its purpose is to ensure "that increasing numbers of young Americans understand and are inspired by the ideas of individual freedom, a strong national defense, free enterprise and traditional values." In Illinois, the YAF sponsored lectures bringing conservative speakers to Illinois colleges and universities. It also held retreats to hear conservative speakers and honor donors.

One of the potential donors was Doris Pistole, who advised the YAF in 2003 that she would make a substantial donation upon her death and repeated this intention to YAF as late as December 2009. In January, 2009 Doris was diagnosed with lung cancer and died in February 2010. During the time of her illness, she contacted her attorney who assisted her in preparing several amendments to her trust, each one superseding the prior one. The sixth and final amendment effectively deprived the YAF of its donation, by providing that charities, such as the YAF, were to receive only that portion of the estate that would otherwise be taxable. 2010 was the year

when federal and state estate taxes were repealed, so YAF received nothing. There was some dispute as to whether this last amendment reflected Doris' intent, but Doris died before another amendment could be signed.

In August, 2010, the YAF sued the trust, trustees, and the Illinois Attorney General, seeking to enforce a charitable pledge. The defendants raised the affirmative defense that YAF was not qualified to "conduct affairs" (analogous to the "transacting business" standard for business corporations). On September 14, 2011, YAF voluntarily dismissed its suit. Just days prior, on September 9, 2011, YAF applied to the Illinois Secretary of State for a certificate of authority, which was granted. In October, 2011, YAF re-filed its lawsuit, which was the subject of the appeal.

The defendants again moved to dismiss the complaint because of YAF's failure to qualify in Illinois, but this time with a twist. Because of the time it took for YAF to file the first complaint, dismiss the first complaint, qualify in Illinois and file the second complaint, the statute of limitations had expired. The defendants argued that the first complaint (filed without YAF qualifying) was "a nullity", so the statute of limitations continued to run and expired by the time YAF filed its second complaint. YAF could not even use the provision in Illinois law permitting plaintiffs to re-file voluntarily dismissed suits within one year, even if the statute of limitations had expired within the one year period. (The court does not discuss the applicable limitations period or the dates involved.)

The trial court agreed with the defendants. Without authority to transact business, the first lawsuit was a nullity and did not toll (i.e., suspend) the running of the statute of limitations. So YAF's second lawsuit was too late.

The appeals court reversed. The decision revived some old legal concepts (and cited old cases). Although the case dealt with a not-for-profit corporation, the principles the court applied also can apply to regular business entities.

- Was YAF Required to Obtain a Certificate of Authority in Illinois?

YAF first asserted that it was not "conducting affairs" in Illinois under Illinois law. Therefore, obtaining a certificate of authority in Illinois, as YAF did, was a precaution and not legally required. YAF lost this argument.

The court had a detailed discussion on the construction of "conducting affairs." The court acknowledged that "conducting affairs" was analogous to "transacting business" for business corporations. But it looked more at parallel statutes in other states. Strangely, the court cited an old non-Illinois case involving the Ku Klux Klan, "*State ex rel. Griffith v. Knights of Ku Klux Klan*, (232 P. 254, Kansas 1925), that held the Ku Klux Klan was "transacting business" in Kansas by owning real property, holding and administering regalia and other personal property, and founding and overseeing member groups. Certainly a court that has to cite a 1925 out-of-state case involving the Ku Klux Klan is not dealing with an abundance of judicial precedents.

In the end, the court found YAF was conducting affairs because it was performing in Illinois the functions for which it was organized. It cited YAF's working with student groups on Illinois campuses, meeting donors in Illinois, holding conferences in Illinois and sponsoring lectures in Illinois. So, the court concluded, YAF was required to obtain a certificate of authority and YAF made the right decision in obtaining one.

- Was YAF Barred By The Statute of Limitations Due To Its Delay In Obtaining A Certificate of Authority?

On this point, YAF fared better. Illinois' statute (similar to its business corporation statute and statutes of other states) does not permit a corporation to "maintain" an action in an Illinois court until it obtains a certificate of authority. The trial court interpreted "maintain" to mean "commence" and found that YAF was barred from even filing the first complaint, rendering it a nullity.

The appeals court disagreed. It cited Illinois Supreme Court cases construing "maintain" as either "commence" or "continue." In YAF's case, the purpose of the statute was not punitive, i.e., to deprive YAF of a remedy. Rather, the purpose was coercive, i.e., to encourage or require foreign corporations to come into compliance with the statute. So a lack of authority to transact business "should not permanently penalize a noncomplying corporation by impairing the validity of its actions." So "maintain" in the statute means "continue", not "commence." So YAF's first action was not a nullity, but served to preserve its claim, since it was filed within the statute of limitations. Similarly, the second action was filed within the time period required to re-file a voluntarily dismissed lawsuit. This is consistent with the purpose of the statute – to encourage corporations to cure their incapacity to sue by obtaining a certificate of authority and paying back taxes and fees.

The lessons from the case show why these types of cases will continue to be rare. A corporation that seeks to be a plaintiff in a state court should make sure it is qualified in that state. Of course, the plaintiff corporation can try to show, as YAF tried, that it is not required to obtain a certificate of authority because it was not "transacting business" or "conducting affairs" in the state. But the path of least resistance and lower cost will almost always be to qualify by obtaining a certificate of authority in the state.

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