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The Effect of Qualification Statutes on Unlicensed Foreign Corporate Commercial Finance Companies: The Doing Business Concept

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NOTES

THE EFFECT OF QUALIFICATION STATUTES ON UNLICENSED FOREIGN CORPORATE COMMERCIAL FINANCE COMPANIES: THE DOING BUSINESS CONCEPT

INTRODUCTION

It is a well-established rule that a foreign corporation which is "doing business" in a state can be subjected to variform regulations[1] since it theoretically has no existence outside the state of its incorporation,[2] except through "comity,"[3] and can be excluded from doing business in the state.[4] The doing business concept has been utilized as a basis of decision for at least three distinct legal questions:[5] (1) whether a foreign corporation is subject to the jurisdiction of state courts for service of process; (2) whether a foreign corporation is subject to state taxation; (3) whether a foreign corporation is obliged to meet the qualification requirements of state foreign corporation acts.[6]

The question whether a foreign corporation is doing business in a state within the meaning of that state's qualification statute is not

1. Isaacs, *An Analysis of Doing Business*, 25 COLUM. L. REV. 1018 (1925).

2. See Bank of Augusta v. Earle, 38 U.S. (13 Pet.) 519, 588 (1839); Paul v. Virginia, 75 U.S. (8 Wall.) 168, 181 (1868).

3. Bank of Augusta v. Earle, *supra* note 2, at 590.

4. See Lafayette Ins. Co. v. French, 59 U.S. (18 How.) 404 (1855). The theoretical power to exclude, of course, would extend only to intrastate activities of the foreign corporation inasmuch as the power would be limited by the commerce clause.

5. Isaacs, *supra* note 1. A fourth category, whether the corporation is subject to state anti-trust laws, has been suggested. TOWNSEND, OHIO CORPORATION LAW 237 (1950).

6. It has been indicated that for each of these questions a different degree of activity is required in order that the corporation be considered to be doing business. Greater intrastate activity is necessary for purposes of taxation than for service of process, but an even greater degree of such activity is required in order to bring the corporation within the qualification statutes. Isaacs, *supra* note 1. See also 45 MICH. L. REV. 218, 219 n.10 (1946); Annot., 146 A.L.R. 941 (1943). This analysis may be explained by the fact that a state, with respect to service of process, is limited only by due process according to traditional standards of "fair play" and "substantial justice," International Shoe Co. v. Washington, 326 U.S. 310, 320 (1945); Note, 16 U. CHI. L. REV. 523 (1949), whereas, in regard to taxation and qualification, the state is also bound by the commerce clause of the Federal Constitution. Annot., 146 A.L.R. 941, 942 (1943); see Isaacs, *supra* note 1. While the courts seldom expressly recognize these distinctions, the conclusion seems to be supported by the results of the cases. See, *e.g.*, State v. Ford Motor Co., 208 S.C. 379, 38 S.E.2d 242 (1946) (corporation held subject to jurisdiction for service of process, but not subject to domestication requirements). The questions whether a foreign corporation is doing business for purposes of jurisdiction for service of process and for purposes of state taxation are beyond the scope of this note.

without its labyrinthian aspects. Generally, it may be said that the activities of a foreign corporation will not be construed as doing business within the meaning of these statutes if the corporation is engaged in "mere solicitation" within the state;[7] but if solicitation is coupled with other activities the corporation's activities may be held to fall within the doing business concept.[8] Similarly, a foreign corporation's isolated or occasional acts within a state will not generally be held sufficient to classify it as doing business[9] unless these acts are the first among an intended series which would be considered as sufficiently continuous to constitute doing business.[10] Further, the intrastate activities of a foreign corporation will not serve as a basis upon which the doing business label can be affixed if these activities are "mere incidents of interstate commerce,"[11] *i.e.*, while a foreign corporation must be doing *some* business in the state in order to be engaged in interstate commerce there,[12] if its activities in the state are labeled interstate in nature, it will not be considered to be doing business in the state *within the meaning of state qualification statutes.*[13] In short, whether an unlicensed[14] foreign corporation will be

7. Kraemer v. Coward, 2 Cal. App. 2d 506, 38 P.2d 458 (1934); Portland Cattle Loan Co. v. Hansen Livestock & Feeding Co., 43 Idaho 343, 251 Pac. 1051 (1926); Yellow Mfg. Acceptance Corp. v. American Oil Co., 191 Miss. 757, 2 So. 2d 834 (1941); J. B. Colt Co. v. Watson, 215 Mo. App. 467, 247 S.W. 493 (1923). *But cf.* Dyson v. Motors Securities Co., 17 S.W.2d 141 (Tex. Civ. App. 1929) (*semble*) (inference appears that if foreign corporation was soliciting, it would be doing business).

8. *E.g.*, Chattanooga Nat'l Bldg. & Loan Ass'n v. Denson, 189 U.S. 408 (1903) (agent solicited and negotiated loans, took real-estate mortgages as security, and delivered checks to borrower); National Mercantile Co. v. Watson, 215 Fed. 929 (D. Ore. 1914) (agent solicited and accepted applications for loans, collected payments, and took real mortgages as security).

9. Cooper Mfg. Co. v. Ferguson, 113 U.S. 727 (1884); United Mercantile Agencies v. Jackson, 351 Mo. 709, 173 S.W.2d 881 (1943); Richmond Screw Anchor Co. v. E. W. Minter Co., 156 Tenn. 19, 300 S.W. 574 (1927). See also Pennsylvania Collieries v. McKeever, 183 N.Y. 98, 75 N.E. 935 (1905).

10. See, *e.g.*, National Mercantile Co. v. Watson, 215 Fed. 929 (D. Ore. 1914).

11. See, *e.g.*, Yarbrough v. Gage & Co., 334 Mo. 1145, 70 S.W.2d 1055 (1934).

12. Isaacs, *supra* note 1, at 1021.

13. *Id.* at 1024. See, *e.g.*, Davis & Worrell v. General Motors Acceptance Corp., 153 Ark. 626, 241 S.W. 44 (1922); *cf.* General Motors Acceptance Corp. v. Huron Finance Corp., 63 S.D. 597, 262 N.W. 195 (1935).

14. An "unlicensed" foreign corporation is one which has not qualified to do business under the state statutes applicable to foreign corporations. These statutes normally require foreign corporations to apply for permission to do business in the state. *E.g.*, ILL. REV. STAT. c. 32, § 157.106 (1955). The application usually requires such information as: corporate name, state of incorporation, addresses of principal place of business in state of incorporation and of intended principal place of business in state to which application is made; name of registered agent in the state; names of states in which it is qualified to do business; names and addresses of officers and directors; purposes for which it was organized; number of authorized and issued shares, and amount of stated capital and paid-in surplus; estimated value of all property and of property in state to which application is made, and estimated amount of gross business it expects to do. *Ibid.* The foreign corporation provisions also require the corporation to appoint an agent for service of process. *E.g.*, DEL. CODE ANN. tit. 8, §§ 341, 347 (1953). It is sometimes provided that if the corporation fails to appoint such an agent, process may be served through a state official. *E.g.*, IOWA CODE ANN. c. 494, § 494.2(6) (1949).

characterized as doing business is to be determined in the light of the aphoristic principle that each case must be decided upon its facts.

If a foreign corporation, doing business in a state within the meaning of the local qualification statute, has failed to qualify, its contracts may be considered void on its behalf, but enforceable against it;[15] it may be precluded from maintaining an action on a contract[16] arising out of the prohibited transaction of business,[17] or on *any* contract or tort;[18] and it may be subjected to the payment of a fine for doing business while unqualified.[19] If the corporation complies with the qualification statute subsequent to the making of a contract it may not be allowed to enforce it.[20] While formerly it was thought that an unlicensed foreign corporation could bring suit based on diversity of citizenship in a federal court if the state statute did not expressly, or by judicial construction, declare the contract void,[21] the most recent decisions indicate that the corporation is also precluded from utilizing a federal forum.[22]

The rapidly expanding economy of the United States is to a large degree dependent upon credit—it has been asserted that the vast

15. *E.g.*, UTAH CODE ANN. § 16-8-3 (1953).

16. *E.g.*, MONT. REV. CODES ANN. § 15-1703 (1947).

17. In Superior Concrete Accessories v. Kemper, 284 S.W.2d 482 (Mo. 1955), it was stated that the fact that a foreign corporation may have been doing business in the state within the meaning of the qualification statute as to some activities does not prevent the performance of another perfectly valid interstate commerce transaction; only the right to enforce contracts made in the unlawful doing of business is lost. This rule, however, is not universally followed. See, *e.g.*, Manhattan Terrazzo Brass Strip Co. v. Benzing & Sons, 72 Ohio App. 116, 50 N.E.2d 570 (1943).

18. *E.g.*, MO. REV. STAT. § 351.595(3) (1949). The Utah Statute provides that the corporation shall maintain no action founded on any contract or tort, as well as providing that the corporation's contracts shall be void on its behalf but enforceable against it. UTAH CODE ANN. § 16-8-3 (1953).

19. *E.g.*, DEL. CODE ANN. tit. 8, § 349 (1953). Under a similar statute, there has developed a recent line of Kentucky cases holding that a foreign corporation doing business in Kentucky without having qualified does not lose its right to sue. Big Four Mills, Ltd. v. Commercial Credit Co., 307 Ky. 612, 211 S.W.2d 831 (1948) (discussing and following prior cases).

20. See Annot., 75 A.L.R. 446 (1931). It has been said that in twenty-six of the forty states in which there are statutes relating to the ability of an unlicensed foreign corporation to sue, a foreign corporation doing business in a state without having qualified can enforce its contracts if it subsequently qualifies. *Unlicensed Foreign Corporations—Enforcement of Contracts*, 20 CORP. J. 223 (1953). But in fourteen states (Alabama, Arizona, Idaho, Iowa, Michigan, Mississippi, Missouri, New Jersey, New York, South Dakota, Texas, Utah, Vermont, and Wyoming) the foreign corporation is precluded from enforcement even if it subsequently qualifies. *Ibid.*

21. *E.g.*, Metropolitan Life Ins. Co. v. Kane, 117 F.2d 398 (7th Cir.), 133 A.L.R. 1171 (1941). The theory was that since the basic nature of the contract was unaffected by the statute, and merely the right to enforce it denied, the question was procedural under Erie R.R. v. Tompkins, 304 U.S. 64 (1938).

22. Woods v. Interstate Realty Co., 337 U.S. 535 (1949); Note, 11 U. PITT. L. REV. 113 (1949); see Angel v. Bullington, 330 U.S. 183 (1947); Guaranty Trust Co. v. York, 326 U.S. 99 (1945).

majority of commercial transactions are conducted upon this basis.[23] To facilitate the efficient operation of the vast commercial network of the United States, there exist numerous financial institutions[24] which supply capital for the use of a highly diversified clientele. While the financing activities of many of these commercial lenders are national in scope and extend to every state in the union, others are more limited in nature. Although some of the larger companies are licensed to do business in every state in which their financing activities are carried on, it appears that many lenders are not.[25] It is the purpose of this note to consider some of the problems which may exist with respect to the question whether a corporate commercial lender will be subjected to the penalty provisions of the doing business statute of a state in which it has lent money and taken security but in which it has failed to qualify.

Because of certain features of the relationship between a foreign financing concern and its customers, there may be a heretofore unrecognized basis for classification of these companies as doing business in violation of local qualification statutes. In order to present more clearly the nature of this relationship, these concerns, for purposes of this note, have been categorized according to the type of customers financed by them. Thus, a consideration of corporations financing dealers in finished consumer durables will be followed by an examination of corporations financing manufacturers and processors.

Corporations Financing Dealers in Finished Consumer Durables

Corporations which finance dealers in finished consumer durables have experienced rapid development during the twentieth century.[26] This growth began in connection with increased production in the

23. Seidman, Finance Companies and Factors 1 (rev. ed. 1956) (hereinafter cited as Seidman). The total outstanding short and intermediate term consumer credit for September 1956 was $40,074,000,000. U.S. Office of Business Economics, Dep't of Commerce, Survey of Current Business, Nov. 1956, p. s-16. More than $30,000,000,000 of this total was installment credit. *Ibid.*

24. In 1952, the estimated number of banks in the United States was 15,000 with a capital of $11,500,000,000; the number of specialized finance companies was about 4,500 with capital funds totaling $2,500,000,000. Silbert, *Financing and Factoring Accounts Receivable,* Harv. Bus. Rev., Jan.-Feb. 1952, pp. 39, 51.

25. Interviews with executives of financing institutions, June 1956, indicate that many of the larger companies are licensed in every state, while others qualify only in those states where regional offices are located. The smaller companies are not licensed in every state. See also the remarks of Seder in Nat'l Conference Receivables Companies, 8th Annual Convention Commercial Finance Industry 173 (1952).

26. Cox, The Economics of Instalment Buying 3 (1948); Seidman 126. See London Guaranty & Acc. Co. v. Watte, 234 Ill. App. 497 (1924).

automobile industry and subsequently has expanded to include practically all other consumer durable goods.[27]

1. Retail Sales Financing

The typical retail financing plan contemplates a sale by a dealer to a purchaser, the latter paying a certain amount as down payment, signing a note payable to the dealer for the balance, and signing a chattel mortgage or conditional sale contract as security. The dealer then indorses the note and assigns the chattel mortgage or conditional sale contract to the lender who usually has given tentative advance approval for the loan. These documents are then sent to the lender for acceptance. If the lender decides to finance this installment sale, it will discount the note and advance the money to the dealer. These facts alone would not appear to warrant the classification of an unlicensed foreign corporate lender as one doing business in the state in which the loan is made within the meaning of the qualification statute. All that appears is that a note and an assignment have been sent for approval to the out-of-state office of the lender who has approved the loan and sent the money to the dealer. This type of transaction, when considered in and of itself, is clearly within the usual concept of interstate commerce.[28]

Consideration of these facts alone, however, does not present a true picture of the nature of the transaction. Typically, the lender will employ solicitors in the state for the purpose of securing the business of the dealers;[29] it sometimes will have representatives in the state to collect notes and to repossess, repair, and sell automobiles which served as security for defaulted loans;[30] and it usually will furnish blank applications for credit and blank conditional sale or chattel

27. SEIDMAN 126. Even though the expansion now includes virtually every type of consumer durable goods, *e.g.*, household appliances, furniture, clothing, and industrial equipment and machinery, the great bulk of these transactions still involve the financing of automobiles. *Ibid.* See, *e.g.*, C.I.T. CORPORATION, PRELIMINARY PROSPECTUS 7 (May 29, 1956), where it is indicated that out of a $1,584,760,000 total retail volume of receivables purchased by C.I.T. Corporation in 1955, motor vehicle installment receivables accounted for $1,352,413,000; of $2,735,856,000 total wholesale receivables purchased, motor vehicle receivables amounted to $2,728,002,000.

28. Jones v. General Motors Acceptance Corp., 205 Ky. 227, 265 S.W. 620 (1924) and General Motors Acceptance Corp. v. Lund, 60 Utah 247, 208 Pac. 502 (1922) are examples of cases involving facts essentially the same as those stated in the text. Since the notes and assignments were accepted outside the state, and the money was mailed to the dealers, the finance companies were held not to be doing business within the contemplation of the statute. See also Industrial Acceptance Corp. v. Haering, 253 Ill. App. 97 (1929).

29. See SEIDMAN 14. See also Yellow Mfg. Acceptance Corp. v. American Oil Co., 191 Miss. 757, 2 So. 2d 834 (1941); General Motors Acceptance Corp. v. Huron Finance Corp., 63 S.D. 597, 262 N.W. 195 (1935).

30. *E.g.*, Equitable Credit Co. v. Rogers, 175 Ark. 205, 299 S.W. 747 (1927).

mortgage forms.[31] In addition, the lender will normally employ agents, or an agency, to investigate the credit status of the purchaser and of the dealer.[32] If each purchase and sale of the dealer's commercial paper is viewed alone, it may be considered to come within the "isolated transaction" exception[33] to the doing business rule; it may be held to be governed by the "mere solicitation" rule;[34] or it may be deemed to come within the interstate commerce immunity[35] because the corporation's activities are mere incidents of interstate commerce.[36] On the other hand, the financing of a dealer's installment sales, under normal circumstances, contemplates the existence of a revolving credit relationship which may last for a considerable period of time.[37] Through the solicitation and investigation activities of the foreign corporate lender, a definite arrangement is established whereby a *continuing* line of credit is created. It is true that there is ordinarily no binding contract between the dealer and the lender:[38] the dealer is not obligated to offer, nor the lender to accept, the former's commercial paper. However, the dealer will normally send *all* of his commercial paper to one financing company because he has established a line of credit,[39] and the company will make every effort to accept all notes and security assignments tendered because of the desire to keep the dealer-customer satisfied.[40] Moreover, the lenders view themselves as an integral part of the installment sales business. The following statement indicates the attitude prevalent in the sales financing business:

> [W]hen we have entered into a financing arrangement with the dealer, that dealer immediately becomes a salesman for us—because he is selling merchandise, he is selling the financing of that merchandise as part of the whole transaction . . . .[41]
>
> . . . .

31. SEIDMAN 14. See also Davis & Worrell v. General Motors Acceptance Corp., 153 Ark. 626, 241 S.W. 44 (1922); General Motors Acceptance Corp. v. Huron Finance Corp., 63 S.D. 597, 262 N.W. 195 (1935).

32. PLUMMER & YOUNG, SALES FINANCE COMPANIES AND THEIR CREDIT PRACTICES 113-14 (1940); Adelson, *The Mechanics of the Instalment Credit Sale*, 2 LAW & CONTEMP. PROB. 218, 219 (1935); Note, 102 U. PA. L. REV. 782, 791 (1954).

33. *E.g.*, United Mercantile Agencies v. Jackson, 351 Mo. 709, 173 S.W.2d 881 (1943); see note 9 *supra*.

34. See note 7 *supra* and text supported thereby.

35. See cases cited notes 28-32 *supra*.

36. See, *e.g.*, Yarbrough v. Gage & Co., 334 Mo. 1145, 70 S.W.2d 1055 (1934).

37. SAULNIER & JACOBY, FINANCING EQUIPMENT FOR COMMERCIAL AND INDUSTRIAL ENTERPRISE 76 (1944).

38. See Adelson, *supra* note 32, at 219-20. For discussions of the techniques involved in installment sales financing, see generally PLUMMER & YOUNG, *op. cit. supra* note 32, at 104-21; Adelson, *supra*.

39. SAULNIER & JACOBY, *op. cit. supra* note 37, at 76.

40. See the remarks of Mathison in AMERICAN INDUSTRIAL BANKERS ASS'N, ANNUAL INSTITUTE OF INDUSTRIAL BANKING 54 (1949).

41. *Id.* at 52.

> When we undertake to service a dealer account, then we become a part of a merchandising operation. . . .[42]

Thus, it appears that the lender maintains a close relationship with the dealer.

2. Wholesale Purchases Financing

The intimacy of the dealer-lender relationship becomes more apparent when it is considered that as a part of the installment financing business the lender has found it necessary to furnish a form of inventory financing.[43] This necessity arose because of the ability of manufacturers of consumer durable goods to insist upon cash terms from the dealers, whose cash assets were usually limited.[44] Thus, in order to secure the more lucrative installment sales financing accounts, the lender began to provide financing of the dealer's wholesale purchases.

In view of the magnitude of consumer installment purchases,[45] it is surprising that few cases have arisen involving a situation where it appeared from the opinions that an unlicensed foreign corporate lender was financing both the installment sales and the inventory purchases of a dealer in consumer durables. The relative dearth of recent cases in this area is perhaps explainable by the obvious fact that litigation is unlikely unless a debt goes bad; and at the present time net credit losses are low.[46] It may also be that many cases are settled without resort to litigation. A further cause of the lack of cases may be that the courts tend to concentrate upon the facts involved in the *particular transaction* upon which the cause of action is based, rather than upon analytical examination of the precise nature of the lender-dealer relationship.

In the case of *General Motors Acceptance Corp. v. Shadyside Coal Co.*,[47] a dealer sold an automobile under a conditional sale contract as security for deferred purchase money notes. In an action against the buyer for a debt the automobile was attached by the Shadyside Coal Company. In an interpleader action, plaintiff General Motors Acceptance Corporation, to whom the purchase money notes had been endorsed and the contract assigned, asserted a claim to the automobile.

42. *Id.* at 53.
43. SEIDMAN 137.
44. *Ibid.*
45. Outstanding short and intermediate term consumer installment credit for September 1956 totaled more than $30,000,000,000. U.S. OFFICE OF BUSINESS ECONOMICS, DEP'T OF COMMERCE, SURVEY OF CURRENT BUSINESS, Nov. 1956, p. s-16.
46. See, *e.g.*, C.I.T. CORPORATION, PRELIMINARY PROSPECTUS 8 (May 29, 1956) where it is stated that C.I.T.'s total net credit losses in the years 1951-55 for all classifications (retail financing, wholesale financing, and factoring) amounted to only 0.18%.
47. 102 W. Va. 402, 135 S.E. 272 (1926).

Shadyside contested plaintiff's right to maintain the action on the ground that plaintiff was an unlicensed foreign corporation doing business in violation of the West Virginia qualification statute. The court held that since the applications of the dealer for wholesale credit and all other commercial paper presented to plaintiff for discounting were received and approved outside of the state plaintiff's activities did not constitute doing business within the meaning of the statute. Plaintiff had furnished financing to West Virginia dealers under two general plans. Under the first, the warehouse plan, cars were stored in a licensed public warehouse until such time as the dealer would advance enough cash to repay plaintiff for the price of one vehicle. When this was done, plaintiff would deliver a warehouse receipt to the dealer who was thus enabled to obtain delivery of the vehicle. Under the second, the floor plan, vehicles were delivered to the dealer upon his execution of a note for the money advanced by plaintiff or upon his honoring trade acceptances, and executing to plaintiff a trust receipt for each automobile as security for the payment of the note or trade acceptances. When the notes or trade acceptances were paid, the trust receipts were released. In addition, there was the usual plan for financing of installment sales whereby the dealer would present purchase money notes and conditional sale contracts signed by prospective borrowers for purchase by plaintiff. While the closeness of the plaintiff's relationship to the dealer cannot be ascertained from the opinion, it would seem to be rather obvious that the typical, well-established system existed. The court, however, simply stated that the only acts on the part of plaintiff occurring within the state were local banking transactions which were limited to the acceptance of security and to repayment of the loans. There was no discussion of the dealer-lender relationship.

In *Snipes v. Commercial & Industrial Bank*,[48] a bank, incorporated in Tennessee, brought an action against a Mississippi automobile dealer to recover under a floor planning agreement, and to recover on commercial paper which had been discounted by the bank. Pursuant to the suit, the bank had attached certain moneys which were in the possession of insurance companies, and which were due to the dealer because of a loss of a building by fire. The lower court rejected the defense, interposed by the dealer and the insurance companies, that the bank was a foreign corporation doing business in the state while unlicensed. The bank had offered evidence tending to show that the original contract and the first loan were made at the bank's out-of-state office, and that the conditional sale contracts and notes were delivered, discounted, and paid at that office. But it was

48. 83 So. 2d 179 (Miss. 1955).

admitted by the bank that it had sent employees into Mississippi to check vehicles on which paper had been discounted, to collect delinquent accounts, and to repossess motor vehicles and other appliances, and that the dealer had, from time to time, accepted payments from his customers for the account of the bank. The evidence also indicated that after the fire, the bank sent several representatives to Mississippi to collect delinquent accounts and that in several instances its representatives accepted payments on current accounts. It sold some automobiles in Mississippi after the sale had been approved by the home office. The Supreme Court of Mississippi simply rejected the argument that the bank was doing business in the state on the ground that this evidence was not sufficient to establish the defense.

These cases are typical of the attitude expressed by most courts. Present judicial opinion seems to ignore entirely the nature of the relationship between the foreign corporate lender and its customer-dealers. As has been shown, this relationship usually is not marked by isolated loans, but is distinguished by a continuing series of transactions.[49] The same lender normally finances both the sales and purchases of the dealer.[50] The commercial finance company commonly employs agents to carry on various activities in the state with respect to its interests there.[51] It customarily exercises varying degrees of control over its customer-dealer.[52] It might be said that the company is a figurative partner, or at least a joint venturer in the consumer durables sales business. The control aspect of the continuing relationship would appear to take the transactions out of the isolated loan category. A new type of relationship is created. If the acts of the corporation are considered individually, it is true that no one of them will be sufficient to constitute doing business. But if its activities are viewed as a whole, it would appear that the corporation is so deeply involved in the operations of the dealer that it can truly be said that its activities are tantamount to those of a partner in the business. "As in all banking arrangements of this type, the balance under such a plan is subject to continuing supervision or policing."[53] The lender is, for all intents and purposes, a party to each sales transaction, and as such, plausibly could be held to be doing business within the meaning of the qualification statutes.

49. SAULNIER & JACOBY, *op. cit. supra* note 37, at 76.
50. SEIDMAN 137.
51. See notes 29-32 *supra*.
52. SAULNIER & JACOBY, *op. cit. supra* note 37, at 76.
53. *Ibid.*

CORPORATIONS FINANCING MANUFACTURERS AND PROCESSORS

1. Accounts Receivable

Financing of accounts receivable is still in a state of comparative flux: it has not yet reached maturity.[54] Accounts receivable financing is designed to provide the manufacturer or processor of goods with liquid capital so that assets in the form of accounts receivable may be put into immediate use.[55] Thus, through this method, the manufacturer or processor is enabled to use its capital in order to produce more goods and to expand sales capacity without the necessity of delay caused by the time required to collect the receivable accounts.[56] This increased liquidity is provided through the use of two principal devices: (1) a loan on the security of an assignment by the borrower of his accounts receivable; (2) an outright sale of accounts receivable to a "factor."[57] Under the former method the borrower is liable for any deficiency if the accounts fail to satisfy the loan, whereas under the latter method the factor ordinarily assumes the risk of loss.[58] Except in the case of the textile industry (where notice to the account debtor is generally given),[59] receivables financing is usually conducted upon a non-notification basis[60] because of the borrower's feeling that notification would advertise a weak financial condition.[61] Thus, the lender will ordinarily grant the debtor the revocable privilege of collecting the accounts for the former.[62] But, in non-notification financing of accounts receivable, if the assignee fails to exercise a legally sufficient degree of control over the cash received by the assignor, there may arise a conclusive presumption of fraud, and the assignment may be deemed void as against creditors of the assignor: the lender must not allow the borrower to exercise such control as to be inconsistent with the existence of a lien, or ownership of the receivables.[63] This duty to police places the unlicensed foreign corporate lender upon the horns of a dilemma. If it has exercised a sufficient

54. Burman, *Practical Aspects of Inventory and Receivables Financing*, 13 LAW & CONTEMP. PROB. 555 (1948).

55. Silbert, *Financing and Factoring Accounts Receivable*, Harv. Bus. Rev., Jan.-Feb. 1952, pp. 39, 39-43.

56. *Id.* at 42-43.

57. SEIDMAN 16-17.

58. *Ibid.*

59. *Id.* at 10.

60. In accounts receivable financing on a notification basis the account debtor is notified by the lender that the account has been assigned and that payment must be made directly to the lender. Where the non-notification technique is utilized, the lender permits the borrower to act as the lender's agent to collect the accounts and remit the proceeds. *Id.* at 17.

61. *Id.* at 10.

62. *Id.* at 42.

63. Benedict v. Ratner, 268 U.S. 353 (1924); Lee v. State Bank & Trust Co., 54 F.2d 518 (2d Cir. 1931). The rule of *Benedict v. Ratner*, however, has been somewhat relaxed in some states. Pemberton, *Notice Filing for Assignments of Accounts Receivable*, 13 LAW & CONTEMP. PROB. 643, 647-48 (1948).

degree of dominion to protect its lien against creditors of the borrower, it may very well have engaged in such a degree of activity in the state as to be deemed to be doing business within the meaning of the qualification statute, and, as a matter of practical financing, the lender will be exercising a considerable degree of control.[64]

The relationship between the lender and borrower, where the latter is a manufacturer or processor whose accounts receivable are being financed, is as close if not closer than the dealer-lender relationship discussed previously. What really exists is a new type of relationship that cannot truly be said to fit into existing categories. Most of the provisions of a typical contract between the borrower and the financer of his receivables are designed to insure the lender of the "greatest possible freedom in dealing with the assigned accounts."[65] Normally, the lender also requires contract provisions establishing detailed audits and accounting procedures whereby faithful performance by the borrower may be assured.[66] The lender makes thorough examinations of the condition of its customer-dealers as well as maintaining efficient auditing and checking systems.[67] For investigation of new loans and for the maintenance of accounts, highly trained investigatory and surveying staffs of auditors and accountants are maintained by most lenders.[68] The services of these staffs are said to be readily available to borrowers for use in the solution of financial problems.[69] On the whole, the control of the lender over the non-managerial activities of the borrower appears to be even greater in the typical financing of accounts receivable situation than that exercised by the lender in the circumstances discussed with reference to an integrated dealer purchase-sales financing plan. Financing of accounts receivable contemplates a series of transactions over an extended period, as opposed to isolated loans.[70]

While in the dealer financing arrangement there exists between the parties a tacit understanding of a continuing relationship, the continuity of the relationship between the borrower and the lender on the security of accounts receivable is required by contract.[71] The financer of accounts receivable is a figurative "partner" in the borrower's business, and should logically be classified as a foreign corporation doing business contrary to the local qualification statute when it has no license to do business in the state.

64. SAULNIER & JACOBY, *op. cit. supra* note 37, at 76.
65. SEIDMAN 45.
66. *Id.* at 50-55.
67. Burman, *supra* note 54, at 556.
68. Silverman, *Factoring: Its Legal Aspects and Economic Justification*, 13 LAW & CONTEMP. PROB. 593, 608 (1948).
69. *Ibid.*
70. SEIDMAN 39.
71. *Ibid.* See also Form A.

2. Inventory

The argument that foreign corporate lenders which finance manufacturers and processors through the use of accounts receivable as security are doing business within the meaning of the qualification statutes, finds additional support in the fact that inventory financing is now a natural counterpart of accounts receivable financing.[72] Inventory is a current asset which, in the absence of financing, obviously cannot ordinarily be utilized to reduce liabilities.[73] Often financing of accounts receivable will not alone provide sufficient liquidity for current business demands.[74] Because inventory cannot be easily liquidated, inventory loans as isolated transactions are so uninviting to lenders[75] that loans will be extended upon the security of inventory only as a part of a general over-all financing plan which includes financing of accounts receivable.[76] Thus, the analogy of the foreign corporation financing manufacturers and processors to the foreign financer of dealers in consumer durable goods is even more tightly drawn. The financer of the dealer provides a form of inventory financing in order to procure installment sales financing business,[77] while the financer of the manufacturer and the processor extends loans secured by inventory as a means of obtaining receivables financing business.

In the absence of statutory authority, a pledge of inventory as security for a loan normally is invalid as against creditors of the borrower if the borrower is allowed to retain possession.[78] The most commonly used inventory security devices are: factor's liens, trust receipts, pledges of public warehouse receipts, and field warehousing.[79] Factor's liens[80] and trust receipts[81] have been authorized by statute in

72. Burman, *supra* note 54, at 561; see also SEIDMAN 11-12.
73. SEIDMAN 72.
74. *Ibid.*
75. Loans on the security of inventory are not attractive to a lender as an isolated transaction because: (1) Since inventory is a relatively non-liquid asset, finance companies may be unable to keep the ratio of their loans at such a liquid level as will allow them to meet obligations on short term borrowings from banks as they mature; (2) The higher the ratio of outstanding loans secured by accounts receivable to outstanding loans secured by inventory, the higher will be the maximum credit to be extended to the finance companies by the banks. *Id.* at 73.
76. *Id.* at 72.
77. See text supported by notes 43 & 44 *supra.*
78. *E.g.*, Security Warehouse Co. v. Hand, 206 U.S. 415 (1907); Gilmore & Axelrod, *Chattel Security*, 57 YALE L.J. 517, 521-22 (1948). An exception to this rule exists where the pledgor has possession for a temporary and limited purpose in order to service the pledge. *Id.* at 522 n.11.
79. Burman, *supra* note 54, at 561. On field warehousing see generally Friedman, *Field Warehousing*, 42 COLUM. L. REV. 991 (1942). On factor's lien acts see generally Skilton, *The Factor's Lien on Merchandise*, 1955 WIS. L. REV. 356; see also N.Y. PERS. PROP. LAW § 45 for an example of a factor's lien act. The UNIFORM TRUST RECEIPTS ACT is to be found at 9A U.L.A. 284 (1951). This statute has been adopted in thirty-one states. 9A U.L.A. 171 (Supp. 1955).
80. Skilton, *The Factor's Lien on Merchandise*, 1955 WIS. L. REV. 356 (statutes collected and analyzed).
81. 9A U.L.A. 171 (Supp. 1955); Skilton, *supra* note 80, at 377-83.

many states and through their use the borrower may be allowed to retain possession with the right to sell the security and retain the proceeds.[82] Because of the lack of possessory control under these statutory devices, it is of paramount importance to the protection of the investment of the lender that the merchandise be frequently checked on the floor of the borrower in order to prevent misappropriation.[83] Constant vigilance on the part of the lender is never in greater demand.[84] Often a lender will place a personal representative or custodian on the premises of the borrower on a permanent daily basis in order to deal with some special aspect of an account or to render an additional service when needed, especially if a factor's lien is involved, or if the "availability plan" of an accounts receivable assignment is in effect.[85] At times the lender will provide the borrower with research services by conducting surveys to ascertain whether the latter's product is likely to be received favorably by the public, and if not, what remedial action should be taken to secure public favor.[86] Indeed, it has been said that "to be successful today, a factor must make some tangible contribution to the welfare, stabilization, or growth of his client."[87] Thus, it appears that the financer of receivables which also finances inventory maintains a truly intimate nexus with manufacturers and processors financed by it. This relationship might well serve as a basis upon which to predicate a holding that if such lenders are foreign corporations which have failed to qualify, they are doing business within the meaning of local qualification statutes and, as such, are subject to the penalty provisions thereof.

While periodic physical test-checks as to quantity and quality are often made by the lender under the usual field warehousing arrangements,[88] it would appear, as in the case of public warehousing situations, that the lender will commonly rely upon the reputation of the independent warehousing concern for the protection of its security interests rather than upon its own "policing methods." Thus, financing under these warehousing plans presents a much weaker case for classification of the foreign lender as doing business in violation of a local qualification statute. Ostensibly, the interstate commerce im-

82. UNIFORM TRUST RECEIPTS ACT §§ 2, 3; N.Y. PERS. PROP. LAW § 45. See also Skilton, *supra* note 80, at 377-83.

83. Burman, *supra* note 54, at 564.

84. *Ibid.*; SEIDMAN 86.

85. Burman, *supra* note 54, at 560. The "availability plan" provides for bulk assignment of all receivables by the client and the drawing of funds as needed without regard to individual invoices. The plan eliminates work-detail in the assignment of invoices. It is most commonly used where billings are voluminous or in very small amounts. *Ibid.*

86. Silverman, *supra* note 68, at 597.

87. *Id.* at 608.

88. Birnbaum, *Form and Substance in Field Warehousing*, 13 LAW & CONTEMP. PROB. 579, 582 (1948).

munity would apply. Nevertheless, it is possible that some courts would approach the question from the broad aspect suggested throughout this note.

CONCLUSION

In light of the foregoing analysis, it is submitted that a real danger exists that many foreign financing concerns could be classified as doing business in violation of local qualification statutes. If the penalty provisions of these statutes are to be enforced equally against all foreign corporations, it would appear that the activities of foreign corporate lenders should be examined with an eye to the totality of their operations. If substance is to prevail over form, the essence of the client-lender relationship should be a determinative factor in each case. As previously indicated, there exists a strong bond of unity between the lending institution and its customer-dealers in consumer durable goods. This bond also exists between the lender and the manufacturer or processor whose accounts receivable and inventory are financed under a typical financing plan. The activities of these financing corporations are not mere incidents of interstate commerce, but are conditions precedent to securing financing business and to enforcing the liens thereby obtained. Considering the activities of the foreign corporate lender from an over-all viewpoint, it is difficult to see how the lender can be said not to be doing business within the meaning of the qualification statutes.

The use of an analogous rationale is not without authority in closely related areas of the law. In cases involving financial institutions which provide financing for dealer installment sales by taking assignments of conditional sales contracts and discounting deferred payment notes endorsed by the dealers, there often arises the question whether the buyer may assert, in an action on the note by the lender, defenses which could have been asserted against the dealer. Is the lender, in such a case, a holder in due course? In the case of *Associates Discount Corp. v. Goetzinger*,[89] a buyer successfully defended, in an action by the lender on a note and conditional sale contract, on the ground that the dealer lacked title to an automobile which was the subject of the sale, even though it was not shown that the lender had notice of the title defect. In *Commercial Credit Co. v. Childs*,[90] the lender was denied the status of a holder in due course because it had prepared commercial paper and received an assignment thereof on the same day. The lender was deemed to be an actual party to the transaction. In these

89. 245 Iowa 326, 62 N.W.2d 191 (1954). See Mutual Finance Co. v. Martin, 63 So. 2d 649 (Fla. 1953) (lender not allowed to claim as good faith purchaser of notes since it was a party from the beginning); Taylor v. Atlas Security Co., 213 Mo. App. 282, 249 S.W. 746 (1923). *But see* White System v. Hall, 219 La. 440, 53 So. 2d 227 (1951).
90. 199 Ark. 1073, 137 S.W.2d 260 (1940).

cases an agency relationship was deemed to exist between the dealers and the lenders, and because of this, notice was imputed to the lender as a legal incident of that relationship.[91] Because of this, defenses which could be asserted against the dealer were allowed to be asserted against the lender. Where a foreign corporation, doing business in a state, sold notes to an innocent purchaser for value without notice, it was held that because the foreign corporate vendor had not qualified the purchaser was not entitled to maintain an action on the notes as a holder in due course.[92] If there was a conflict between the foreign corporation law and the negotiable instruments law, the former was to prevail.[93]

Thus, the courts appear to be inclined to hold that an unlicensed foreign corporation, because of its relationship to its dealer-client, is not a holder in due course, and, in addition, will allow the policy of the most severe penalty provisions of the foreign corporation qualification statutes—denial of access to the courts—to abrogate the effect of such an established statute as the Negotiable Instruments Law. It should certainly not come as a surprise if some of these courts should decide to extend the theory of these decisions so as to subject an unlicensed foreign corporation not only to the less harsh penalties, but also to preclude enforcement of its chattel liens.

While obviously it must be conceded that the adoption of the analysis herein suggested would add little to commercial practicability, the purpose of this note has been to suggest that such a result would be possible under most of the penalty provisions of the various statutes requiring qualification by foreign corporations. Given the existence of such a statute, a decision denying the right of an unlicensed foreign corporation to enforce its claims and chattel liens ostensibly would be well founded in logic. But it is submitted that whatever the relative merits of the other penalty provisions, denial of the right to enforce otherwise valid claims is unjustifiable as a matter of policy. However, the quarrel is not with the mode of analysis which would reach such a result, but rather with the intemperate policy of the means of enforcement. The remedy is legislative, not judicial. Denial of the right of an unlicensed foreign corporation to maintain an action was sanctioned by these statutes for the ostensible purpose of insuring the receipt of taxes by the state and the protection of its citizens against

91. Note, 28 NOTRE DAME LAW. 251, 253 (1953).
92. First Nat'l Bank v. Parker, 57 Utah 290, 194 Pac. 661 (1920).
93. *Ibid.*

irresponsible acts by the corporation.[94] The desired end, however, could more nearly have been accomplished through less invidious means.[95]

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94. Comment, 59 YALE L.J. 737, 746 (1950). Neither of these purposes is satisfied by the penalties imposed, and the benefit goes to the unjust enrichment of the debtor. *Ibid.* See also Woods v. Interstate Realty Co., 337 U.S. 535, 539-40 (1949) (dissenting opinion).

95. *E.g.*, ILL. REV. STAT. c. 32, § 157.125 (1955), while providing that a foreign corporation cannot maintain an action while unlicensed, nevertheless leaves the validity of its contracts unimpaired. The teeth in this statute consist of the authorization of a suit by the state to recover all fees and taxes which would have been paid by the corporation had it complied with the statute, plus a 10% penalty.