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SALES-AUTOMOBILE DEALER FINANCING AND THE BONA FIDE PURCHASER

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SALES—AUTOMOBILE DEALER FINANCING AND THE BONA FIDE PURCHASER—With the prospect of increased manufacture of automobiles for civilian use, the problem of financing the dealer and his customers will again loom large. In the past the burden has largely been assumed not by banks, whose credit practices and collection machinery are better adapted to short term, single payment credits,[1] but by the finance or acceptance companies. These organizations mushroomed into prominence after World War I as retail installment selling became more and more prevalent, and with the "easy payment plan" offered by the dealer to the retail buyer, there was produced a corresponding need by the dealer himself to be financed. The stock in trade of the car dealer is relatively expensive and his usual working capital relatively small. The sales finance companies have been willing to extend credit for the dealer's wholesale purchases from the manufacturer and to buy up the retail purchaser's installment contract from him, assuming the risk of successful collection.[2] In both wholesale and retail financing the company has a major interest in obtaining adequate security for the credit risk and shielding it from the claims of the dealer, his creditors, and his vendees. The relations of the company with the latter, the purchaser who buys from the dealer in the ordinary course of business, will be examined here.

Financing the dealer himself may involve loaning money to him directly or financing his purchases of a number of cars from the manufacturer, i.e. "wholesale financing." In either case it is likely that the only security available will be automobiles, the dealer's stock in trade. They are valuable and easy to identify, but, when the debtor has possession, he may sell one in the usual course of business to a buyer who is without actual knowledge of the security interest held by the finance company. Who shall prevail? The finance company has the dealer's personal obligation which is usually evidenced by a promissory note,[3]

[1] LLEWELLYN, CASES AND MATERIALS ON THE LAW OF SALES 763 (1930).

[2] It is interesting to note the relation which the amount invested bears to the rate of profit in the two types of financing. In speaking of finance companies as a whole, it has been said, "Wholesale financing, which constitutes 10 to 20 percent of receivables outstanding and a much higher proportion of volume (because of more rapid turnover than in retail business), accounts for scarcely more than 5 to 10 percent of gross income. . . . For ten local sales finance companies, selected according to availability of data, income from wholesale financing averaged 5.5 percent of gross income in 1937, ranging from 3.2 to 11.7 percent; wholesale credit averaged 42 percent, however, of all credit extended." PLUMMER AND YOUNG, SALES FINANCE COMPANIES AND THEIR CREDIT PRACTICES 245 (1940).

Competition among finance companies centers around the dealer, not the consumer. The companies oblige him by charging him a relatively low rate of interest in his wholesale financing expecting him to reciprocate by giving them his retail installment paper where the rate of interest is high and the profits considerable.

[3] The note is negotiable for ease of transfer and is usually made in a separate instrument from the contract in order that negotiability will not be questioned.

and has been given or retained legal title in the cars as security. Assuming the dealer to be uncollectible, can the lender assert his property interest against the innocent purchaser? Let us look at some of the devices commonly used for the security interest.

In many places a chattel mortgage is used. The lender advances the money to pay the manufacturer and in return receives a mortgage on the cars purchased, the dealer-mortgagor remaining in possession. There is some dispute as to the location of legal title,[4] but generally the courts are familiar with mortgages, and all states have provision for their recordation.[5] The mortgage may also be used to secure a direct loan to the dealer on cars already owned by him.

A device presupposing title to be in the finance company is the conditional sale. Of course, the lender is not in the business of selling cars, but in order to effect the security transaction, title is taken by the finance company directly from the manufacturer by payment of the bill of lading, and a conditional sale contract is executed to the dealer, who in turn takes possession. The authorities have had some difficulty in swallowing the idea that this is really a sale with reservation of title. Bogert says it is a chattel mortgage in disguise,[6] and some courts have taken this position.[7] Indeed, such contracts may be declared by statute to be chattel mortgages.[8] Although in abstract legal principle a distinction between the conditional sale and the chattel mortgage may be made,[9] the two seem to overlap somewhat in the case of retention of title as security.[10] Jones says, "It is quite evident that such a contract is intermediate between a conditional sale and a chattel mortgage, with characteristics of each, and it is just as evident that the courts have reared it by judicial construction to fit the exigencies of particular cases. A given

[4] Under the common-law theory the mortgage operates as a transfer of title subject to defeasance only by full payment. In re Herkimer Mills Co., Inc., (D.C., N.Y. 1930) 39 F. (2d) 625; the modern tendency is that a lien on the property is created with title remaining in the mortgagor. Stoddard v. Ploeger, 42 Idaho 688, 247 P. 791 (1926).

[5] Hanna, "The Extension of Public Recordation," 31 COL. L. REV. 617 at 638 (1931).

[6] Bogert, "The Evolution of Conditional Sales Law in New York," 8 CORN. L. Q. 303 at 304 (1922).

[7] Kelley v. Brack, 214 Ky. 9, 282 S.W. 190 (1926); In re Caver, Caver & Co. (D.C., Miss. 1930) 42 F. (2d) 293; and in case of doubt as to whether the instrument is a chattel mortgage or a sale, it is said that the law favors construing it as a chattel mortgage. Perkins v. Skates, 220 Ala. 216, 124 S. 514 (1929).

[8] Garretson v. DePoyster, (Tex. App. 1891) 16 S.W. 106; see also McClain v. Saranac Mach. Co., 94 Colo. 145, 28 P. (2d) 1009 (1934).

[9] In the conditional sale general ownership and title are in the seller with no reference to a lien. In the mortgage situation in some jurisdictions the mortgagee is considered to have a lien only.

[10] ESTRICH, INSTALLMENT SALES, § 77, p. 117 (1926).

contract will be declared to be that kind of transaction toward which its characteristics predominate." [11] Unlike Shakespeare's rose, the name attached to this transaction is all important. If a contract be recorded by the finance company as a conditional sale and it is subsequently identified as a chattel mortgage by the court, the misfiling may deprive the lender of the constructive notice given by the recording statute.

A third security device used is the trust receipt. The procedure is much the same as that followed in the conditional sale situation. The lender pays the purchase price and takes title from the manufacturer, entrusting possession to the dealer who gives a trust receipt reciting that title is to remain in the finance company as security for the money advanced and that the dealer holds the cars in trust for the company and will use them in the manner specified by the trust receipt.[12] One advantage of using this method is that the holder of the trust receipt may retake the property at any time,[13] but, on the other hand, the courts have had a considerable amount of trouble in defining the true legal nature of a trust receipt. It has been called a bailment,[14] an agency,[15] a pledge,[16] a conditional sale,[17] and a chattel mortgage.[18] Perhaps a functional definition is the most appropriate, but at any rate it must be observed that the lender should apprise himself of the attitude of the court toward it in each particular jurisdiction, for the law surrounding each one of these legal concepts is apt to be different.

Armed with one of these implements of security the finance company hopes to be able to strike down all claimants under the dealer. The purchaser for value in the course of business has a shield of innocence, for he has no actual knowledge of the interest of the company. Which is the stronger? It is clear that the dealer does not actually have complete ownership, but he does have possession and may have actual or apparent power to sell. It is on one of these that the innocent purchaser must rely in order to succeed.

If the dealer has actual authority to sell the cars to purchasers, it may be either express or implied. In cases where the authority to resell is expressly embodied in the dealer-finance company contract with the proceeds to be paid to the finance company, the validity of a sale made

[11] 3 JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES 40 (1933).

[12] Harding v. First-Mechanics Nat. Bank of Trenton, 113 N.J. Eq. 129, 166 A. 142 (1933).

[13] Charavay & Bodvin v. York Silk Mfg. Co., (C.C., N.Y. 1909) 170 F. 819.

[14] General Motors Acceptance Corp. v. Hupfer, 113 Neb. 228, 202 N.W. 627 (1925).

[15] 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES, rev. ed., § 557, p. 960 (1940).

[16] Hanna, "Trust Receipts," 29 COL. L. REV. 545 at 550 (1929).

[17] Mershon v. Moors, 76 Wis. 502, 45 N.W. 95 (1890).

[18] Karkuff v. Mutual Securities Co., 108 N.J. Eq. 128, 148 A. 159 (1930).

thereunder cannot be denied even though the proceeds of it are not turned over to the lender.[19] This power of sale remains even though the dealer himself has defaulted in his own obligation.[20] However, if the dealer's sale is not in the ordinary course of business as contemplated in the creation of the agency, the rule will not apply[21] but no attempt here will be made to explore sales by the dealer other than in the course of his business.

Implied agency is somewhat harder to identify, but it is just as much an actual agency as that which is expressly spelled out in a contract. In an early English case, *Pickering v. Busk*,[22] Lord Ellenboro said in effect that if the owner of a chattel entrusts its possession with a dealer, the agency to sell cannot be denied. The statement is too broad and is not good law,[23] but the circumstances surrounding the dealer's possession may indicate an implied in fact agency, as from previous course of dealing,[24] or knowledge that the obligor-dealer intends to sell in his business.[25] If implied agency can be established, the nature of the security device used, the effect of recordation or the bona fides of the purchaser need not be considered, because the dealer is carrying out precisely what he is authorized to do. This type of agency may be avoided by an express and meaningful prohibition.[26]

More complications arise when the purchaser claims to have relied on the apparency of the dealer's power to sell. He may appear to the

[19] Where finance company put dealer in possession to sell and pay proceeds to the company, it was held that no recovery by the finance company could be had against the innocent purchaser. Commonwealth Finance Company v. Schutt, 97 N.J.L. 225, 116 A. 722 (1922).

[20] Peasley v. Noble, 17 Idaho 686, 107 P. 402 (1910).

[21] Andre v. Murray, 179 Ind. 576, 101 N.E. 81 (1913); see also L.R.A. 1917B at 659.

[22] 15 East 38, 104 Eng. Rep. 758 (1812).

[23] 1 WILLISTON, SALES, 2d ed., § 314, p. 720 (1924).

[24] The security is held to be waived. Brown Bros. and Co. v. The William Clark Co., 22 R.I. 36, 46 A. 239 (1900); Stockyards National Bank of South Omaha v. Harris Wool Co., 316 Mo. 426, 289 S.W. 623 (1926); Spooner v. Cummings, 151 Mass. 313 at 316, 23 N.E. 839 (1890).

[25] Where conditional seller knew that the vendee bought horses for resale in his business, the vendor's silence amounted to an implied license to sell them in the regular course of trade. Rogers v. Whitney, 91 Vt. 79, 99 A. 419 (1916); Zerr v. Howell, (Tex. Civ. App. 1935) 84 S.W. (2d) 867. As to conditional sales, § 9 of the Uniform Conditional Sales Act says, "When goods are delivered under a conditional sales contract and the seller expressly or impliedly consents that the buyer may resell them prior to the performance of the condition, the reservation of property shall be void against purchasers from the buyer for value in the ordinary course of business, and as to them the buyer shall be deemed the owner of the goods, even though the contract shall be filed." 2 UNIFORM LAWS ANNOTATED, Conditional Sales, § 9, p. 15 (1922).

[26] U.S. Motor Truck Co. v. Southern Securities Co., 131 Miss. 664, 95 S. 639 (1923).

prospective buyer to be the owner or at least to be an agent with authority to sell. In either case the dealer appears to have power to sell. The apparency of this power is the controlling feature, not its supposed source in agency or ownership. Out of this there arises the argument of estoppel which is expressed in the leading case of *Boice v. Finance and Guaranty Corp.*,[27] "It is true that, as a rule, the seller of personal chattels cannot confer upon a purchaser any better title than he himself has, but if the owner stands by, and permits a seller, who is a licensed dealer in such goods to hold himself out to the world as owner, to treat the goods as his own, place them with other similar goods of his own in a public showroom, and offer the same indiscriminately with his own to the public, he will be estopped by his conduct from asserting his ownership against a purchaser for value without notice of his title." This general rule does not go as far as the early common-law idea that retention of possession by any mortgagor amounts to fraud.[28] And too, it is true that merely entrusting a chattel with a dealer will not support the reliance of a third party on him as owner, for the whole law of bailments to dealers would be destroyed.[29] But if it appears that the owner of the property, or as in the case of the finance company, the owner of a security interest in the property, is silent as to its use and knowingly allows the dealer to represent himself as having the power to pass title, the bona fide purchaser will succeed.[30] It may be difficult to decide whether in such case there is actually an implied agency to sell or merely an apparent one. These terms are sometimes confused by the courts.

A somewhat harder case to decide is the situation where the dealer is expressly forbidden the right to sell the cars and his possession limited to exhibition or storage. There can be no question of implied authority here, but the denial of the power to sell may not be enough to defeat the buyer of the car displayed. There is some authority for the proposition that if a dealer sells in contravention of such a limitation the security holder will not lose his interest, his knowledge of the dealer's practices notwithstanding;[31] but the weight of authority favors

[27] 127 Va. 563 at 570, 102 S.E. 591 (1920).

[28] Tyne's Case, 3 Co. Rep. 80a, 76 Eng. Rep. 809 (1601).

[29] Where the owner of a diamond ring entrusted it with a dealer to obtain a match for it, it was held that bare possession in the dealer is not enough to estop the true owner as against an innocent purchaser from the dealer. Levi v. Booth, 58 Md. 305 (1881).

[30] Moore v. Ellison, 82 Colo. 478, 261 P. 461 (1927); Bernhagen v. Marathon Finance Corp., 212 Wis. 495, 250 N.W. 410 (1933); Bass, Heard, and Howle Co. v. International Harvester Co., 169 Ala. 154, 53 S. 1014 (1910); Glass v. Continental Guaranty Corp., 81 Fla. 687, 88 S. 876 (1921).

[31] Utica Trust and Deposit Co. v. Decker, 244 N.Y. 340, 155 N.E. 665 (1927); General Credit Corp. v. Rohde, 122 Conn. 100, 187 A. 676 (1936).

an estoppel.[32] The general attitude of most courts seems to be that a duty rests upon one who is financing a retail dealer to see to it that cars in which he has an interest are not left on the salesroom floor to be offered to the public.[33]

The position of the holder of security interest is not without hope. He may have recorded. Although the finance companies as a whole oppose recordation requirements as expensive and burdensome, the record offers a means of attacking the good faith of the purchaser. Recording acts in the United States are by no means universal, nor are they uniform. There are recording acts for chattel mortgages in all the states, for conditional sales in most, and for trust receipts in almost none.[34] The provisions vary and no attempt will be made at a detailed analysis here, but as might be expected, the courts have differed as to the effect that the constructive notice imparted by the statute will have on the purchaser. Some courts have adopted a literal interpretation of the constructive notice provisions, holding such notice to be the legal equivalent of actual notice to all persons, the nature of the seller notwithstanding.[35] The better and more realistic view favors the innocent purchaser over the dealer.[36] Aside from the estoppel idea, the principal basis for reaching such a decision is the desire for fluidity of commerce in retail sales. It would be an onerous task for every prospective car purchaser to have to examine voluminous mortgage and conditional sales records before buying from a retail dealer in the course of trade.[37]

[32] American Aggregates Corp. v. Wente, 100 Ind. App. 59, 190 N.E. 552 (1934); Universal Credit Co. v. Reily, 171 Okla. 286, 42 P. (2d) 516 (1935); Missouri Finance Corp. v. McCowan, 108 Kan. 622, 196 P. 614 (1921); Truck, Tractor & Forwarding Co. v. Baker, 281 Pa. 145, 126 A. 239 (1924); Finance Co. of N.J. v. Jones, 98 N.J.L. 165, 119 A. 171 (1922).

[33] "Secret arrangements which place it in the power of a dealer to deceive unsuspecting purchasers should be and they are condemned." Western States Acceptance Corp. v. Bank of Italy, 104 Cal. App. 19 at 23, 285 P. 340 (1930).

[34] See note 5 supra.

[35] Finance and Guaranty Co. v. Defiance Motor Truck Co., 145 Md. 94, 125 A. 585 (1924); Whitehurst v. Nixon, 196 N.C. 823, 146 S.E. 599 (1929).

The notice is of the security contract and through it, the nature of the dealer's title. It behooves the finance company to specify expressly any limitations on the dealer's authority to sell in order for the notice to cover both the titular and agency aspects of the dealer's possession.

[36] Kearby v. Western States Securities Co., 31 Ariz. 104, 250 P. 766 (1926); Helms v. American Security Co., 216 Ind. 1, 22 N.E. (2d) 822 (1939); Denno v. Standard Acceptance Corp., 277 Mass. 251, 178 N.E. 513 (1931); see also annotation 136 A.L.R. 821 (1942).

[37] "It is a matter of common knowledge, and will therefore be judicially noticed, that in large cities there are department stores in which a customer can buy almost anything from a nut-cracker to a threshing machine, from a doll carriage to an automobile. It would never occur to a customer that he must be on his guard to see whether the article was bulky, of large value, and easily susceptible of identification, and if so, to examine the registry for liens thereon. Besides many of the articles carried in such

Another argument advanced is that the finance company and not the purchaser is better situated to absorb the loss occasioned by defaulting dealers.[38]

In retail financing the possibility of the question arising is not so likely. The usual procedure in financing the retail purchaser is for the dealer to make a contract of sale reserving title until payment of the notes given by the purchaser. The contract and notes are then assigned to the finance company in exchange for the balance of the purchase price due. Ordinarily at this point the dealer is eliminated from the picture, for the purchaser, as a general rule, will take possession and keep it; but sometimes the dealer may keep or retake possession himself, and then resell the car to an innocent purchaser. Repossession often occurs when the original purchaser is in default. If the finance company knows of this, the case will be decided on agency principles, but if there is no knowledge and no permission, a subsequent purchaser from the dealer cannot rise to a position superior to that of the assignee-finance company.[39]

An interesting situation appears in *Gump Investment Company v. Jackson*[40] where the company took an assignment and recorded it, but, unknown to the assignee, the dealer did not deliver the car to the first buyer but retained it and sold it again off the showroom floor to an innocent purchaser. The first sale was apparently collusive. It was held that the investment company could not assert its reservation of title even though it did not actually know of the dealer's possession, had no reason to suspect it and had recorded the assignment. Here the finance company did not knowingly stand by and allow the dealer to deceive the public. The court does not expressly rely on estoppel but emphasized the right of the innocent purchaser to believe the dealer really was the owner. Although the result is not too satisfactory in legal theory, it does reflect the stand taken by most courts in protecting the retail purchaser if possible.[41] However, there are still the "constructive notice

stores would be on the border line, and it would be unreasonable to require a purchaser to determine what could be mortgaged and what could not. To require an examination of the records for liens in such cases would break up the business, and indeed be an embargo on legitimate trade. Capital must seek a more substantial security for its protection. Otherwise it were better that the few should suffer than the general public who have been lured into purchasing from a dealer who has been entrusted with the indicia of ownership." Boice v. Finance & Guaranty Co., 127 Va. 563 at 570, 102 S.E. 591 (1920).

[38] Adelson, "The Mechanics of the Instalment Credit Sale," 2 L. AND CONTEMP. PROB. 218 at 242 (1935).

[39] 47 A.L.R. 85 at 104 (1927).

[40] 142 Va. 190, 128 S.E. 506 (1925).

[41] It is difficult to apply estoppel here, for the finance company, ignorant of the dealer's possession, cannot be said to have conducted itself in such a manner as to deceive innocent parties. See BIGELOW, ESTOPPEL, 6th ed., 607 (1913).

In Drew v. Feuer, 185 Minn. 133, 240 N.W. 114 (1931), in facts almost paralleling those in the Gump case, the court felt that the recording statute gave suffi-

absolutists" who contend that the buyer cannot be innocent if the reservation of title contract has been recorded.[42]

It seems clear that the law offers very little protection to the finance company in guarding its security interest against a bona fide purchaser from the dealer in the usual course of his trade. The courts suggest that losses can be absorbed by higher interest charges,[43] but it must be remembered that the automobile finance business is highly competitive. Perhaps the best way to insure against loss is to be certain of the dealer. His solvency and responsibility are reflected not only by his financial statements, credit references and the like, but also his previous payment record and that of his customers should be closely scrutinized, and the trend of his business carefully marked.

There is some legislative aid in sight. It has been proposed that the states provide for central filing of all contracts concerning automobiles and that a registration of title certificate be required of all motorists, with the existence of encumbrances to be noted thereon by the agency issuing them.[44] It is hoped that this system will give the purchaser ample notice of the true state of title. Until then, an ounce of prevention in the way of close dealer observation is advisable.

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cient notice to the purchaser and expressly refused to follow the Gump case. The court added, however, (at p. 136) that the purchaser could still succeed under the Uniform Fraudulent Conveyances Act as adopted in Minn. Stat. (Mason, 1927) § 8467 which provides:

"Every sale by a vendor of goods and chattels in his possession or under his control, and every assignment of goods and chattels, unless the same is accompanied by an immediate delivery, and followed by an actual and continued change of possession of the thing sold or assigned, shall be presumed to be fraudulent and void as against the creditors of the vendor or assignor and subsequent purchasers in good faith, unless those claiming under such sale or assignment make it appear that the same was made in good faith." Thus a reservation of title made under a collusive sale was void as against an innocent purchaser. The dealer's assignment to the finance company would not validate it. This is easier to digest than a vague estoppel theory or a result based on ill-defined public policy.

[42] "The learned trial court felt as all must feel that the purchaser in dealing with an apparently reputable concern, housed in an extensive building and carrying a large stock, acted but naturally in neglecting to search the chattel mortgage records, and therefore placed the loss on the Bank (mortgagee). But while we sympathize with the purchaser we feel that our recording statute, which makes every chattel mortgage duly filed and indexed, 'full and sufficient notice to all the world,' must be considered and given some weight, and therefore the rule that the trial court attempted to apply, 'when one of two innocent persons must suffer; he whose conduct was the cause of the loss must bear the loss,' cannot be applied here because under the statute the purchaser had constructive notice and cannot in law be said to be an innocent party." Hardin v. State Bank, 119 Wash. 169 at 172, 205 P. 382 (1922).

[43] Sorenson v. Pagenkopf, 151 Kan. 913 at 918, 101 P. (2d) 928 (1940).

[44] Myerson, "Practical Aspects of Some Legal Problems of Sales Finance Companies," 2 L. AND CONTEMP. PROB. 244 at 250 et seq. (1935).