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CHATTEL SECURITY: II

GRANT GILMORE†

The Trust Receipt

The trust receipt or something very like it first appeared in our reports in a case decided before 1850 and another of the earliest cases involved a grain shipment on the Great Lakes. Nevertheless the device did not come into prominence until the end of the century and was then used exclusively in transactions originating in overseas shipments to this country. Its invention and development furnishes in our legal history a unique example of response to a rapidly changing industrial pattern.

The trust receipt was worked out by the banks in their capacity as financiers of import shipments. The widespread use of bank credits to finance imports (mostly of raw materials) developed earlier than their use to finance domestic shipments: the bank's assurance of payment was a necessity to the foreign shipper, who was usually unable to post himself on his buyer's current credit standing. Furthermore, in view of the chaotic nineteenth century American banking scene, the guaranty—letter of credit—had to come from a bank known to be sound. Thus, not banks generally, but only the large banks in the principal ports, mostly on the eastern seaboard, were the originators of the trust receipt.

The perfection of the system of pledging goods in transit to the financing bank by indorsement of an order bill of lading left the bank

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† Assistant Professor of Law, Yale University Law School. Allan Axelrod, presently of the University of Nebraska College of Law, who collaborated with me on Part I of this article, was not, because of his removal to Nebraska, able to continue his planned collaboration on Part II. I am deeply indebted to Mr. Axelrod for his aid and criticism in the preparation of Part I and have drawn freely on his research at various stages in the present instalment. The conclusions expressed in this instalment are of course implicit in the approach adopted in Part I, and the formulation of the ideas here expressed has been immensely aided by discussion with Mr. Axelrod. It would not be proper, however, to saddle him with the responsibility of authorship of a paper which it has not been possible to submit to him.

1. Fletcher v. Morey, 9 Fed. Cas. 266, No. 4,864 (C.C.D. Mass. 1843). The first case in which the term "trust receipt" was used to describe the instrument was apparently Barry v. Boninger, 46 Md. 59 (1876). On the early history of trust receipts excellent articles are Frederick, The Trust Receipt as Security, 22 Col. L. Rev. 395, 546 (1922); Hanna, Trust Receipts, 29 Col. L. Rev. 545 (1929); Hanna, Trust Receipts, 19 Calif. L. Rev. 257 (1929).


3. A convenient summary of trust receipt law is McGowan, Trust Receipts (1947), designed for the layman (i.e., banker) but nonetheless useful to the lawyer. A fairly complete bibliography of law review literature on trust receipts is found in Bogert, Cases on Sales 284, 285 (2d ed. 1947).

4. See Part I of this article, 57 YALE L. J. 517, (1948).
in absolute control of the goods on their arrival. The bank had already paid for the goods by honoring drafts under the credit, yet typically would not be reimbursed until after the goods had been processed and resold. The bank was careful not to thrust itself in any way into the sale contract: the risk of the goods moved directly from seller to buyer, never through the bank, and all questions of contract performance were left to be adjusted between the parties to the sale. The bank could not therefore, and indeed would not, figure as a conditional vendor to its customer; a mortgage lien was available but unsatisfactory.

The instrument drafted by counsel for the banks provided that, in consideration of the bank’s releasing the goods to its customer, for processing and resale, 1) the bank should have the right at any time during the manufacturing process, without prior notice and for any reason it deemed sufficient, to retake the goods and hold them as a pledgee in possession after default; and 2) the bank’s lien rights should survive the resale after processing and attach to the proceeds of sale with the same force and effect as to the goods. The statement of conditions possibly suggests the analogue of a wrongdoer holding property (or its proceeds) on a constructive trust for his victim; such a flight of fancy may explain the curious choice of “trust” to describe the receipt incorporating the bank’s terms which the customer signed. The customer—trustee—was not of course a wrongdoer and unlike the trustee, ex maleficio or otherwise, never had “legal title” to the goods, which the bank reserved to itself. Despite the possibilities of confusion, the trust terminology seems never to have given any trouble.

The bank had now achieved exactly what it wanted, along with the incidental benefit of freedom from recordation—if the instrument would stand up in court to give the financer a reasonable degree of protection against competing creditors as well as the stated rights against the borrower himself. The danger was that the judges, alert to detect uniformity in diversity, would look upon the trust receipt and call it a chattel mortgage or a conditional sale; in either case the bank, not having filed under the applicable statute, would lose its lien and rank as an unsecured creditor in the borrower’s insolvency. Fortunately, as a result of the geography of its birth, the early trust receipt cases came before the best-trained commercial courts of the period, and those courts had little hesitation in ruling favorably to the new device.

5. The leading early cases upholding the trust receipt as an independent security device were Mechanics & Traders’ Bank etc. v. Farmers & Mechanics’ National Bank, 60 N.Y. 40 (1875), and Farmers and Mechanics’ Nat. Bank v. Logan, 74 N.Y. 568 (1878). The Connecticut courts were more skeptical, finding the elements of a conditional sale in the trust receipt transaction, New Haven Wire Co. Cases, 57 Conn. 352, 18 Atl. 266 (1888). Charavay & Bodvin v. York Silk Manufacturing Co., 170 Fed. 819 (C.C.S.D.N.Y. 1909) reviews the early cases at length, particularly distinguishing the trust receipt transaction from the conditional sale, and arriving at a decision favorable to the entrusting bank.
No legal institution, however shiny from the mint, can long escape being tarnished by theory. The very newness and, so to say, the legal nakedness of the trust receipt made speculation about its "underlying nature" attractive. As if the creative effort of inventing the trust receipt had exhausted the legal genius, the ensuing theoretical discussion was sterile in the extreme; instead of looking to business practice, the writers—and judges—concentrated on the form which the trust receipt had taken and reasoned from legal premise to legalistic conclusion.

Two widely held beliefs from what might be called the "middle period" of trust receipt theology are worth noting. One derived from observation of the regular course of events preceding the usual trust receipt transaction: passage of "legal title" to the goods from seller to financing bank, by indorsement and delivery of the bill of lading, and from financing bank to buyer, but only after reimbursement of advances made. The conclusion was that a trust receipt transaction must always be a "tripartite" affair in which, of necessity, the "title" moved directly from seller to financing bank without ever passing through the buyer. Consequently, any method of handling the documents which deviated ever so slightly from the standard letter of credit operation ran the risk of being held not a "true" trust receipt transaction: for example, draft drawn on the buyer payable at his local bank, honored by means of a credit put at the buyer's disposal by the local bank against a guaranty or actual advance of funds to the local bank by the financing bank (located in another city), bill of lading sent by seller to local bank and delivered to buyer against payment of the draft, trust receipt executed by buyer in favor of financing bank. As stated, the transaction was "bad" from the orthodox point of view—the local bank was said to be the buyer's "agent" and thus "title" flashed through the buyer en route to the financing bank. The defect could probably be cured by having the seller draw the draft, not on the buyer but on the local bank itself, which might then be said to act as "agent" for the financing bank, thus insulating the buyer from the fatal contamination of "title." However the papers were shuffled, the buyer got possession of the goods only after payment to the seller by money put up by the financing bank.

6. The "tripartite theory" of trust receipt transaction is common to most of the early cases and articles and indeed is still orthodox. The necessarily tripartite nature of the trust receipt is strenuously urged in Vold, Sales 341 et seq. (1931); see also Bacon, A Trust Receipt Transaction 1, 5 Ford. L. Rev. 17, 40 (1936).

7. See Vold, Sales 370 (1921): "If the purchaser pays the draft with his own funds and thus secures the bill of lading for the goods, and thereafter arranges to convey the goods to the financing house as security for advances, the security transaction is bipartite, and will be at once recognized as in fact a chattel mortgage . . ." citing Keystone Finance Corporation v. Krueger, 17 F.2d 904 (C.C.A. 3d 1927); New England Auto Investment Co. v. St. Germaine, 45 R.I. 225, 121 Atl. 393 (1923); Finance & Guarantee Co. v. Stitt, 21 F.2d 718 (C.C.A. 3d 1927).

but one way was "good" and the other "bad." If the trust receipt trick were as complicated as that, the device would have a limited future.

Another line of speculation bore on the nature of the buyer's interest after he had received goods under trust receipt. It was clear that he was not a trustee, although called one, since he lacked legal title. By definition he was neither a conditional vendee nor a chattel mortgagor. Still he must be something. Some thought they had perceived the "true nature" of the affair when they hit on the idea of agency—the buyer as "agent" and the bank as "principal". This idea achieved a certain currency at one time and still has its proponents. At first blush it was attractive to the banks, since it seemed to increase their hold over the goods and particularly over the proceeds. The reverse of the medal, however, bore the terrifying inscription that the principal is liable for his agent's acts. The banks, who were after all in the transaction only for a small return, reacted reasonably enough against the idea that they should bear the risks of the enterprise. Some courts, on the other hand, casting for common-law analogues, were favorably impressed by the agency idea.

Until after the first World War the trust receipt was used almost exclusively in financing imports of raw materials, and as late as 1930 a leading court in a leading case found it necessary to devote a part of its opinion to rebutting the argument that a trust receipt transaction could not be used

9. See e.g., 2 Glenn, Fraudulent Conveyances and Preferences 961 (1940): "What, then, is the nature of this [i.e., trust receipt] transaction? . . . [It] cannot be viewed as either a conditional sale or as a chattel mortgage, as we understand those terms. At best it is an agency arrangement. . . ." The language quoted was taken without change from the first edition of Professor Glenn's work, The Law of Fraudulent Conveyances 528 (1931). And cf. 1 Williston, Sales 794 (2d ed. 1924): "It has become customary for the banker to entrust the ultimate owner with the goods or documents of title, taking from him what is ordinarily called a trust receipt, but sometimes, and more accurately, an agency receipt. . . ."

10. See particularly Foreign Trade Banking Corporation v. Gerseta Corporation, 237 N.Y. 265, 142 N.E. 607, 31 A.L.R. 932 (1923) (entrusting bank against purchaser from trustee claiming set-off against bank on unrelated indebtedness of trustee to purchaser; held, on undisclosed principal theory, bank subject to set-off. The bank alleged in its complaint that the trustee held the goods "as agent" under the trust receipt.) But see T. D. Downing v. Shawmut Corp., 245 Mass. 106, 139 N.E. 525, 27 A.L.R. 1522 (1923) (entrusting bank not liable to set-off arising from claim of customs broker against trustee for advances made to get the goods through customs.) "The importer was in no proper sense the agent of the banker. . . . The case at bar is distinguishable from Moors v. Wyman, 146 Mass. 60, 15 N.E. 104 (1888), where the trust receipt itself expressly stated that the custodian of the merchandise held it as agent for the banker. . . . That principle [agency] does not control on the facts here disclosed. . . . The trust receipt here in issue is essentially different in tenor and in legal effect." 245 Mass. 106, 113. Before the Downing case, the Massachusetts courts had, relying on Moors v. Wyman, gone off along agency lines. Professor Glenn, commenting on the Gerseta and Downing cases, consistently concludes that he prefers the former. 2 Glenn, op. cit. supra note 9, at 963.
to finance domestic shipments. The tremendous expansion of the automobile industry occasioned the first notable use of the trust receipt outside the import case. In ever increasing numbers the cars streamed from plant to dealer and from dealer to consumer entirely on credit. Moreover, one result of the industry's expansion on a scale and with a speed both without precedent, was that the retail dealers, haphazardly recruited, were not infrequently men of doubtful integrity, insufficient business experience, or both. Certainly the case reports during the 'twenties abound with instances of fraudulent activity by dealers—double financing having been the most popular. Thus not only was a tremendous dollar volume of financing needed, but, the risks involved being appreciably greater than usual, the financer had to have a tight hold over the security. The trust receipt, which allowed the security-holder to descend on the security with the greatest dispatch and least trouble, soon came to be, in all jurisdictions which recognized the trust receipt as an independent security device, the approved method of dealer finance. The success of the trust receipt in the automobile field led to its being used also in the domestic shipment of other relatively expensive articles—electric refrigerators, washing machines and so on. And with its growing acceptance as a domestic device, a number of the large banks, which for fifty years used it in the import trade exclusively, have come to use it across the board in all their financing operations of manufacturers and dealers alike, indifferently in the import and domestic fields.

The promulgation in 1935 of the Uniform Trust Receipts Act, drafted by Professor Llewellyn of Columbia, and the Act's quick adoption in the principal commercial states 12 made the coming of age of trust receipt law an exceptionally happy majority. At a time when trust receipt law was bogged down in the sterile academics of tripartite and agency theories, Professor Llewellyn studied commercial practice and scrapped the accompanying theory. Any transaction, in which a dealer's or manufacturer's incoming stock is financed by a third party who never acquires more than a security interest in the goods, can qualify as a trust receipt transaction under the Act's involved series of definitions. It makes no difference how the papers are shuffled so long as the described situation is reached. Excluded from qualifying are the fi-

11. In re James, Inc., 30 F.2d 555, 557 (C.C.A. 2d 1929); see comment on the James case in Hanna, Trust Receipts, 29 Col. L. Rev. 545 (1929).
12. Between 1935 and 1945 the Act was adopted in 21 states, including California, Illinois, Massachusetts, New Jersey, New York, Pennsylvania. McGowan, op. cit. supra note 3, collects the statutory references. In several states the Act as passed differed from the Uniform Act in one important respect. See note 15 infra.
13. Thus §2 (1) (b) provides in part: "The security interest of the entruster may be derived from the trustee or from any other person . . .", solving the difficulties discussed. p. 763 supra.
nancing of 1) consumer sales, 14 2) stock, not incoming, but already in the possession of the dealer or manufacturer, 15 and 3) any transaction in which the financer has at any time more than a security interest in the goods. 16 The trust receipt under the Act is thus restricted to the financing of goods in motion by financing agents who do not share in the profits of the enterprise. The financer—"entruster" in the Act's terminology—is given wide powers over the security. He may repossess "on default, and as may be otherwise stipulated in the trust receipt" 17 and, after repossession taken, holds the goods "with the rights and duties of a pledgee." 18 His lien, after sale by the trustee of the goods entrusted, attaches to the proceeds not only against the trustee but against all classes of creditors as to whom his security interest in the goods was valid; 19 only a "buyer in the ordinary course of trade" (defined so as to exclude subsequent mortgagees and pledgees) acting in good faith and without notice can take the goods free of the entruster's interest. 20 Finally, to dispose of the agency theory, the entruster is

14. Under §2 (3) a transaction does not qualify as a trust receipt transaction unless the trustee's possession is for the purpose of sale, exchange, manufacturing or processing for ultimate sale, etc.

15. Under §2 (1) (a), to qualify as a trust receipt transaction, goods, documents of title or negotiable instruments must be delivered to the trustee by the entruster or some third person. Under §2 (1) (b) documents or instruments (but not goods) may be in the hands of the trustee at the outset of the transaction, provided the entruster gives new value. An important modification of the Act, as passed in some States (e.g., California and Connecticut), was the addition to §2 (1) of a new subsection (c) "validating, as a trust receipt transaction, the giving of new value by the entruster against the transfer to the entruster of a security interest in goods in the possession of the trustee and retained by the trustee. The addition of the amendment validates the trust receipt in the financing of old stock. See In re Boswell, 96 F.2d 239 (C.C.A. 9th 1938) (bankrupt purchased goods on open account; the bank "thereafter" loaned money and took back a trust receipt on the goods; bank allowed to reclaim the goods from the trustee in bankruptcy). Professor Llewellyn has referred to the addition to the Uniform Act of the amendment in question as a disempowering, manhandling, changing, and submitting to mayhem and destruction. See Proceedings of the Forty-eighth Conference in Handbook of the National Conference of Commissioners on Uniform State Laws 105, 106 (1938).

16. The definition of "entruster" is "the person who has or . . . takes a security interest. . . ." The owner of goods who sells on credit, retaining title or a security interest, is expressly excluded. A buyer, making advances to his producer to enable the producer to acquire new inventory, would seem to qualify.

17. §6 (1).

18. §6 (2).

19. §10. The provisions of the section are somewhat complicated. The entruster's right to proceeds is conditioned on a duty to account in the trustee, not waived by the entruster's actions; where he has the right, his lien is good as to all identifiable proceeds and to such non-identifiable proceeds as were received by the trustee within ten days of the institution of insolvency proceedings.

20. §9 (2) (a) (i). There has been some alarmist feeling that the decision in Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943), has made all trust receipt financing vulnerable to attack as voidable preferences by the trustee's (i.e., borrower's) trustee in bankruptcy. See discussion of the Klauder case in Part I of this
“not . . . responsible as principal or as vendor under any sale or contract to sell made by the trustee.” 21

Although nowhere at common law were trust receipts subject to recording statutes, and although the statement had been authoritatively made that there were peculiar reasons why trust receipts should not be so subjected, 22 the Act provides for filing as a condition of the entruster’s securing maximum protection, except that, for reasons of commercial convenience, the entruster is protected for thirty days without filing. 23 Building on an ingenious Ohio statute, 24 the filing provisions call for a single annual statement, filed centrally by states and not by counties, of intention (by a named entruster) to engage in trust receipt financing with a named trustee covering specified kinds of commodities or goods. 25 The statement of intention once filed makes it unnecessary to file separately for individual transactions as they occur.

article, 57 Yale L. J. 517, 521 n.7 and references there cited. If the Klauder case invalidates trust receipts, then it also invalidates all chattel mortgages in which the mortgagor has power of sale (by stipulation in the mortgage or by virtue of the mortgagor’s holding the goods for resale) and all conditional sales for resale. The language used by the Court in the Klauder case, if taken out of context, does read on the proposition that any security device which allows a bona fide purchaser of the security to take free of the lien is subject to attack as a voidable preference. In this article, it is confidently assumed that the Klauder case does not have the expansive meaning suggested. In the Klauder case the Court was dealing with a type of financing (non-notification assignment of accounts receivable) which (rightly or wrongly) it considered to be shady business and the type of bona fide purchaser it had in mind was a subsequent lienor, mortgagee or pledgee. There is little warrant for taking the language in the Klauder case to be applicable to “respectable” financing devices where the bona fide purchasers are ordinarily retail buyers of goods. Cf., however, Hanna, Preferences in Bankruptcy, 15 U. of Cin. L. Rev. 311, 326 et seq. (1948), taking the position that, while trust receipts may be saved, as statutory liens under § 67(b) of the Bankruptcy Act, from the wreckage left by the Klauder case, nevertheless conditional sales for resale and power of sale chattel mortgages are doomed unless § 60(a) is amended. Professor Hanna sets out in the article cited a proposed revision of § 60(a) which would do the trick.

21. §12.
22. In re James, Inc., 30 F.2d 555, 558 (C.C.A. 2d 1929). For reports of interviews with representatives of financial houses explaining their reasons why trust receipts should not be subjected to filing requirements see Hanna, Trust Receipts, 29 Col. L. Rev. 545, 559 et seq. (1929).
23. § 8. Steffen and Danziger, The Rebirth of the Commercial Factor, 36 Col. L. Rev. 745, 761 n.90 (1936), say that for several years the Act “. . . was hung up in committee on the question of whether full recording as demanded by agricultural states, or none at all in accordance with the holdings of the courts of the commercial eastern seaboard should be favored.”
24. Ohio Gen. Code § 8568 (1938), providing for the entruster’s filing in the county of the borrower’s principal place of business an affidavit that the entruster “. . . has arranged for financing the purchase of certain imported goods or merchandise or ready marketable staples . . . and describing in general terms the kind of [goods, merchandise or staples] to be covered. . . .” As Steffen and Danziger, op. cit. supra note 23, point out, the filing provisions of the Uniform Trust Receipts Act also resemble the provisions of N.Y. Prop. Law § 45. For a more recent development from § 45, see p. 770 infra.
25. § 13.
We have mentioned before the continuing attempts to achieve a floating charge on shifting stock in the line of credit situation. The Act does not, formally at least, go that far since the entruster’s lien attaches only to the particular goods described in the trust receipt. In view of the relatively slight inconvenience entailed in executing a series of trust receipts to cover successive shipments (at least where the bills of lading in any case pass through the entruster’s hands), it may be said that the entruster has the substantial benefit of a floating charge. At any rate, it considerably eased the problem of securing a line of credit, first, by the simplified filing provisions, and also by the provisions which permit an entruster, on condition of maintaining a reasonably thorough policing of the trustee’s affairs, to subject to his lien the proceeds of sale of the entrusted goods. Under chattel mortgage and conditional sales law, the lien vanished with the goods. Now, thanks in part to the analogy of the trust res, the lien continues to attach to the substituted proceeds, provided the entruster exercises a not unreasonable degree of diligence—so that the lender can in the shifting stock situation, even though he may not technically have his floating charge, protect himself against being relegated to the mourning bench of the unsecured creditors.

**Recent Statutory Developments**

To round out our study we must notice briefly two types of statutes which have been coming into favor over the past ten years or so.

The first is a so-called “Factor’s Act” which has cropped up in over a dozen states: not a Uniform Act so far as the National Conference of Commissioners on Uniform State Legislation is concerned, it has nevertheless been enjoying more success than most of the commercial legislation sponsored by the Conference in recent years. The states which have adopted the new factor legislation have not all passed it in identical form, but the bones of the legislation are the same wherever it appears.

The factor, old-style, was an agent for sale, a commission man who disposed of his principal’s goods. If we judge from the remedial legis-

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26. Listed are some of the statutes which are sufficient to give a general picture of the new legislation:

- **Conn. Gen. Stat., §§ 918h–926h (Supp. 1945).**
- **N. C. Gen. Stat., § 44-70 through 76 (Supp. 1945).**
- **Ohio Gen. Code, § 8364-1 through 7 (Page, Supp. 1946).**
- **Tex. Civ. Stat., Pamph No. 4 § 5506c (Vernon, 1947).**
- **Va. Code, § 5224a (Supp. 1946).**

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27. For an excellent discussion of the factor generally, both old and new style, and the development of his lien, see Steffen and Danziger, *supra* note 23.
lation widely adopted in the nineteenth century, the principal trouble
with factors was that they were prone to dispose of the principal's goods
without authority or contrary to instructions, and under our title-
bound sales law there was a good chance that one dealing with a factor
would take goods subject to prior claims of ownership. The early Fac-
tor's Acts, therefore, dealt principally with that problem, and were de-
signed to protect good faith purchasers from factors. There was no
thought that the factor himself was in need of protection. It was ap-
parently not uncommon for factors to make advances to their prin-
cipals, and the factor had at common law a lien to secure such advances
on all goods of the principal actually coming into the factor's hands.
There the law of the matter rested for a long time.

The factor, new-style, under the acts we are presently con-
sidering, is a very different breed of cat: he is "any person, firm, bank or corpora-
tion . . . which advances money . . . on the security of goods or
merchandise, whether or not it is employed to sell such goods or mer-
chandise." "Goods and merchandise" are defined as meaning raw
materials, work in process and finished goods intended for sale, exclud-
ing equipment, machinery and trade fixtures. The "borrower" is
broadly defined as "the owner of the merchandise or goods . . . who
borrows from, and as security therefor creates a lien . . . in favor of,
a factor." The factor is given a "continuing lien upon all such goods
or merchandise in the custody or possession of the borrower as are
from time to time designated in a writing signed by the borrower and
delivered to the factor" to secure the factor for all advances made.

28. The typical language of the Factor's Acts was that any factor "entrusted" with
the possession of goods or documents of title for the purpose of sale "shall be deemed to be
the true owner thereof, so far as to give validity to any contract" made by the factor for
the sale or disposition of the goods or documents. See N.Y. Pers. Prop. Law § 43; gen-
erally, 1 Williston, Sales § 317 et seq. (2d ed. 1924).

29. See Steffen and Danziger supra note 23, at 743 et seq.

30. For purposes of illustration we shall use the Connecticut version of the Act (see
note 26 supra), and make incidental reference to the more interesting local variations. The
Connecticut statute (Conn. Gen. Stat., §§ 918h-926h (Supp. 1945)) will in the follow-
ing discussion be cited by section number only.

31. § 918h.

32. This is standard language in most of the statutes. Texas, however, excludes
"stock of goods, wares or merchandise daily exposed to sale in parcels"; Ohio ex-
cludes motor vehicles. Maryland excludes all electrical and mechanical household or
industrial equipment or accessories (apparently at any stage of manufacture and distribu-
tion). Massachusetts speaks merely of "merchandise" and "receivables" with no descrip-
tive or exclusionary language.

33. The Massachusetts statute, even more broadly, merely describes the borrower as
"the person creating the lien." Missouri specifies that nothing in the Act "shall be con-
strued to mean that the borrower must be engaged in manufacturing or processing;"

34. § 919h. The term "continuing lien" is common to all, being derived apparently
from § 45 of the New York Personal Property Law. Under the Connecticut statute the lien
The lien is conditioned upon the factor's posting a sign on the premises where the goods subject to his lien are kept and on his filing at the county office a notice of intention to engage in financing the borrower together with a "general description" of the goods which are or may become subject to his lien. The lien is stated to be "effectual . . . as against" unsecured creditors and subsequent lien creditors except for named types of liens mainly statutory; "purchasers for value in the ordinary course of the business of the borrower" take free of the factor's lien, despite filing or actual knowledge. No foreclosure provisions are included in the Act.

The Act is apparently the bastard offspring of an unhallowed union between Section 45 of the New York Personal Property Law and the Uniform Trust Receipts Act. Section 45 defines factor to include pledgees and consignees who advance money on goods consigned to or pledged with them, whether or not such pledgees and consignees are employed to sell the goods; the streamlined definition of factor in the new Acts proceeds clearly enough from that source. The sign-posting and filing provisions are also patterned on the provisions of Section 45. The provision that the lien attaches to such goods as are desig-

Note: The text continues with references and further explanations.
nated in a writing signed by borrower and delivered to factor gives us something very like a trust receipt. The affirmative provision that current course purchasers take free of the lien simplifies the elaborate provisions of the Trust Receipts Act.43

The Act is a model of bad drafting.44 Does it cover agricultural crop loans? Presumably not, but a good lawyer might be able to make the point stick. Do “purchasers for value in the ordinary course of the business” include subsequent mortgagees and pledgees? It is impossible to tell. While Section 45 provides for filing a statement indicating “the general character of merchandise” subject to lien, and the Trust Receipts Act demands a statement indicating “the kind or kinds of goods” financed, our Act calls for “a general description of the goods or merchandise.” Quaere whether the omission of some such word as “kind” or “character”, has inadvertently required filing of the chattel mortgage type, describing particular goods. Such examples could be largely multiplied.

The Act seems to make the same compromise with floating charge theory that the Trust Receipts Act worked out: although the filing of a general statement of an intention to engage in financing protects the lender against adverse claimants, his lien attaches to only such goods as are from time to time “designated” in a writing signed by the borrower and delivered to the “factor”. “Designated” is hardly a word of art and conceivably could be taken to mean a general description of the type or character of goods to be subjected to the lien; more likely, in view of the legal background, it will be construed to demand a particularization of actual goods in the borrower’s custody.45 Assuming the more likely construction of “designated”, we are no nearer a floating charge than ever.46 This failure was not serious in the typical trust receipt situation, where the goods come to the borrower through the entrusting bank; where the goods come directly to borrower from his vendor, the non-floating character of the lien may be of importance to the lienor. The Act seems to create one more device for establishing a lien, whose incidents are almost completely undefined, available in almost every lending situation, and coextensive with chattel mortgage liens and conditional sales liens. The Act permits something very like

43. Of course, no matter what security device is used, where the goods are held by the borrower for resale the current course purchaser takes free of lien. The same result will no doubt obtain in New Jersey, which, as pointed out note 38 supra, omits this provision.

44. Particularly the Connecticut version. Enough has been said in the preceding footnotes, however, to make clear that the other versions, if they avoid some of the Connecticut vices, have others no less reprehensible.

45. Plus after-acquired goods of the same type; there may be some inconsistency between §§ 919h and 920h.

46. Even in the versions which extend the lien to proceeds, there is the requirement that the goods be described or designated in writing, or, alternatively, consigned or pledged (constructively) to the factor.
trust receipt financing without any of the safeguards written into the Uniform Trust Receipts Act; where it is, so to say, piled on top of the latter, the possibilities of confusion are enormous and interesting.

Before leaving the factor, we shall notice a proposed extension of the old-style factor's lien contained in Section 54 of the Uniform Revised Sales Act. Under proposed Section 54 a financing buyer (who will be typically, although not always, a factor or selling agent) is, without any requirement of sign-posting, filing, segregating, marking, tagging or the like, given a lien to the extent of advances made to the seller for a particular production operation on all goods which "have become identified as intended for the contract." The lien is described as being good "as against any person but one purchasing in current course of trade." Banks and finance companies, who do not "buy" the goods will not be beneficiaries of the lien, but the true or old-style factor seems to have an answer in prospect to all his prayers. If the section is read, for one example, in the light of a contract under which Factor is to take Manufacturer's entire output for resale, Factor apparently takes a lien on everything in the plant—inventory, work-in-process, finished goods—by force of the sales contract alone, even though that contract contains no lien provisions and with no requirement of notice to other creditors. The lien is certainly designed to be good against unsecured claims; subsequent mortgagees and pledgess for value will apparently have a position superior to the factor; the status of the borrower's trustee in bankruptcy or other representative of creditors is not clear. Section 54 was designed, no doubt, to make the forward contract of sale a more effective device to protect the financing buyer than it is under present law. Taken by itself it validates a secret lien to an extent hitherto unheard of; we must, however, consider that the Revised Sales Act is only one article of a proposed comprehensive code, and that provisions in other articles, when the entire code is drafted, may mitigate the apparently revolutionary nature of Section 54 by subjecting the lien acquired under that section to the filing and notice requirements adopted in other security situations.

The other field in which there has been notable recent legislative activity is that of sales to the ultimate—i.e., non-business, non-industrial—consumer for use. Here two ideas have been competing for supremacy. One is to regulate the form of contract that may be used and to require in the contract a conspicuous statement and full disclosure of the principal elements of the bargain. Typical of this approach is legisla-

47. Which is the case in six of the states listed in note 26 supra as having the new-style Factor's Act.

48. An excellent article on recent legislation in this field is Donaldson, An Analysis of Retail Installment Sales Legislation, 19 Rocky Mt. L. Rev. 135 (1947). The reader is referred to Mr. Donaldson's article for statutory references and comprehensive discussion,
tion enacted in New York in 1941. All conditional sales contracts and purchase money chattel mortgages amounting to fifteen hundred dollars or less executed in connection with the sale of goods "for any use other than a commercial or business use" must contain certain specified information: itemization of the cash price, credit service charge, insurance premium and other charges, as well as the amount of the down payment, allowances and other credits, and the due date and amount of subsequent instalments. The entire contract (or mortgage) must be printed in at least 8-point type and an executed copy must be delivered to the buyer (or mortgagor). On seller's failure to comply with the provisions of the act, the buyer is given the right to recover the amount of the service charge (or ten per cent of the price if no service charge is specified). 51

A more elaborate approach is exemplified by a Retail Instalment Sales Act adopted in Indiana in 1935. 52 This Act comprehensively covers conditional sale contracts, chattel mortgages and any "other instrument" giving "the seller a security interest" in goods sold where the price is not in excess of fifteen hundred dollars. 53 The same kind, and substantially the same degree, of specification in the contract of the elements of the price is required as in the New York legislation. The Indiana Act, however, goes far beyond the New York legislation in establishing a State Department of Financial Institutions with rulemaking, licensing and regulating powers. The Act provides that no person shall purchase retail instalment contracts from sellers without first being licenced, the license to be issued on an application in proper form if the Department finds "that the applicant can operate its business economically and efficiently." The Department is further empowered to make rules and regulations under the Act, to make sweeping examinations of its licensees and to revoke licenses for failure to cooperate in

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49. N.Y. Pers. Prop. Law § 64-a (McKinney, Supp. 1947). The Uniform Conditional Sales Act (with some variants) was adopted in New York in 1922 (id. § 60 et seq.). The New York Conditional Sales Act was conformed to the Uniform Act by amendments added in 1941.

50. N.Y. Lien Law §§ 239-239k (McKinney, Supp. 1947). The subsections of the Act substantially apply the provisions of the Conditional Sales Act (as to redemption etc.) to the chattel mortgages affected.

51. In addition to the consumer legislation set out above, New York passed at the same time acts dealing with chattel mortgages on agricultural crops (N.Y. Lien Law § 230-b (McKinney, Supp. 1947)) and chattel mortgages by motor vehicle dealers (id. § 230-c).

52. Ind. Stat. Ann. § 58-901 through § 58-934 (Burns, 1943). An attack on the constitutionality of the Act (successful in the District Court) was dismissed by the United States Supreme Court on the ground that the amount in controversy necessary to give federal jurisdiction was not established. McNutt v. General Motors Acceptance Corp., 298 U.S. 178 (1936).

53. The New York restriction in coverage to non-commercial, non-industrial sales is not included.
examinations or for wilful non-compliance with provisions of the Act or rules and regulations issued thereunder.\textsuperscript{54} Other noteworthy provisions of the Act are designed to prevent restraints on competition by tie-ups between manufacturers and finance agencies, by kick-backs from financier to dealer, and so on.

One other statute worthy of mention is the Maryland Retail Installment Sales Act of 1941.\textsuperscript{55} Like the Indiana Act, the Maryland Act (which has a two thousand dollar ceiling) establishes a licensing department with powers over finance companies comparable to those of the Indiana department. The Maryland statute goes beyond the Indiana version in not only requiring a breakdown of charges but in affirmatively prohibiting in the contract confession of judgment clauses, insecurity clauses, clauses in which the buyer waives tort claims for repossession without legal process, wage assignments, and so on.

In view of the importance which consumer instalment sales have assumed in our economic life, and the impossibility of establishing by any type of legislative fiat an equality of bargaining power between the parties, administrative regulation with licensing and rule-making powers, as in the Indiana and Maryland statutes, seems necessary and proper. Contract regulation alone, without a supervisory agency, seems both inadequate and insufficiently flexible. Disclosure to a vendee who is factually not in a position to make an alternative choice or litigate his rights will do little to curb the manifest abuses of consumer instalment sales. The setting up of an agency does not however, in our opinion, dispense with the need for a thorough-going revision of the basic law which the agency is to administer.

**Proposals**

Summing up the results of our survey, we submit the following report:

A money-lender wishing to take security for an advance has a variety of legal devices available to him. With the exception of the trust receipt, in those states which recognize the trust receipt and, more particularly in those states which have adopted the Uniform Trust Receipts Act, none of those devices is tailored to fit any particular financing situation. The borrower may be farmer, manufacturer, distributor or consumer: the lender, in theory at least, has the same rights and remedies against any one that he has against any other. The whole is a confused amalgam of bits and pieces that reflects contemporary (or almost contemporary) business and social needs fitted into patterns

\textsuperscript{54} In addition to the licensing sanctions, it is provided (§ 58-908) that no contract violating the provisions of the Act with respect to charges shall be enforceable against any buyer for any amount in excess of the principal balance.

that made sense in a now vanished society and still persist in a society differently articulated. Chattel mortgage law and conditional sales law are what they are, not because any one in his right mind ever thought that such a body of law made sense, but as a result of a long process of tinkering to make late-medieval legal forms workable in an industrialized society. We might as well hope to solve our transportation problems by fitting an ox-cart with a jet-propelled engine.

The uneasy and inexpert joining of past with present, a phenomenon inherent in any system of law, is exaggerated under a common-law system. The genius and beauty of the common law—considered as a methodology rather than as a body of substantive rules—is that it overtly recognizes and provides a supple and loose-jointed framework for the co-existence of past and present. In any field of substantive law we can isolate the same type of historical overlay, distortion of form and function, and hesitant makeshift that we have noted in our survey of chattel security devices.

The sponsors of the proposed Commercial Code include in their prospectus an article on Chattel Security, to run with their revisions of the earlier Uniform Acts. Since the air is filled with the hum of drafting, we shall, in the hope of being of some slight use to the draftsmen, proceed from descriptive generality to recommendation.

First of all the traditional line of chattel security devices—chattel mortgage, conditional sale, trust receipt and so on—should be abolished. Each one (with the exception of the trust receipt) has accumulated in its train too much old and bad law; each one can be used in too many different situations; under each one the creditor has one set of rights and remedies with which to deal with debtors differently situated, with the result that his powers are now too sweeping, now unduly restricted; the use of each device is hedged around with arbitrary and whimsical rules designed to meet situations which have now vanished leaving only the rules behind them.

In place of the traditional catch-all devices there should be substituted a series of liens designed to cover particular financing situations. That is: a financer advancing money or extending credit against chattel
security in a given situation would, no matter what he chose to call his transaction, come under the rules established for that situation. It should be emphasized that the following discussion refers to new-value financing only; no protection is proposed for the creditor who would lift himself by his bootstraps through the taking of a security agreement at some indefinite term after the making of an initially unsecured advance. In the author’s opinion the following situations require separate treatment:

(1) The financing of the manufacture and distribution of goods (through lien on inventory).

(2) The financing of the sale of machinery, equipment and fixtures to industrial and commercial users.

(3) The financing of the sale of goods to individual (i.e., non-industrial and non-commercial) consumers.

(4) The financing of agricultural products.

The foregoing listing is offered tentatively: on investigation other situations may prove to require separate treatment. The proposed categories cover only the situations where possession and use of the goods subject to lien is in the borrower during the loan period: the pledge, documentary or physical, has never caused any particular difficulty, and our pledge law is reasonably satisfactory.

(5) Financing Manufacture and Distribution.

In both manufacture and distribution, where financing is done against the security of inventory or stock in trade, the goods subject to lien have as their principal characteristics (in so far as their use as security is concerned) that they are held for sale and that as the inventory or stock is depleted by sale it will be replenished by like goods. They are goods in motion, and the only way the borrower can ever pay off the loan is to move them, converting them into cash or accounts receivable. Since the borrower is conducting a going enterprise and wants a continuing line of credit, some or all of the proceeds will (except in certain seasonal industries, e.g., canning) have to go to replenishment of inventory or stock.

Under these circumstances there is no good reason to perpetuate the common-law prejudice against a floating charge. The filing system adopted in the Uniform Trust Receipts Act points an easy way to solution of one of the few real technical difficulties under a floating charge theory: adequate notice and description of a claimed lien on a shifting stock of goods. The objection to a floating charge has never been buttressed by much else except outdated metaphysics; the arguments in its favor have been sufficiently indicated in earlier discussion. Once the idea of a floating charge on shifting stock is accepted, there seems to be no reason why the financer’s lien should not attach to the
proceeds of goods sold as well as to replacements of stock and inventory, so long as the proceeds have not passed out of the borrower's hands in current course of trade—i.e., in purchasing new inventory or stock in replacement of that sold—and subject to a duty on the part of the financer to police what the borrower actually does with the proceeds. Provided the lien attaches not only to new stock as it comes in but also to the proceeds in the borrower's hands arising from the disposition of old stock, there would seem to be no reason why any current course disposition by the borrower of goods subject to the lien should not pass the goods free of the lien: the financer is adequately protected by his lien on the proceeds and needs no right to follow the goods themselves.

The validation of such a lien might have unexpected repercussions on our financing structure inasmuch as certain practices have developed which might never have been invented if a floating charge had been possible. Field warehousing, for example, is a device which may owe its existence in large part to the virtual impossibility of giving a valid lien on working inventory. If an effective lien is provided without the cumbersome procedure of segregating the liened goods under independent control, the function performed by field warehousing would be limited to providing insurance against a borrower's dishonesty. The growing business of accounts receivable financing would also be affected; a lien which attaches both to goods and proceeds would make the separate financing of accounts receivable—i.e., proceeds—unnecessary if not impossible. Presumably a borrower would give a lien on both to the same financer.

Suppose, however, that a dealer who has taken into stock an automobile subject to a financer's lien disposes of the automobile to a consumer on a contract of conditional sale and discounts the contract with a bank, which pays the dealer cash on the discount transaction. The original financer's lien clearly extends to the cash received on the discount. Assume, however, that the cash has been dissipated; should the original financer, if he has duly filed prior to the discount, be allowed to claim that the bank holds the chattel paper subject to the financer's lien? The question is one of real difficulty. The author's inclination is to allow the bank to take free of the lien on the ground that the financer

58. That is to say, if the financer wants the proceeds he should go and get them at reasonably short intervals; the "unfettered dominion" talk in the Benedict v. Rather line of cases has a great deal of sense in it. See the policing requirements adopted in § 10, Uniform Trust Receipts Act. It is simple enough to say "the lien should attach to proceeds". Where the proceeds are cash, the situation is relatively simple. Where, however, the proceeds are credit instruments—chattel paper, trade acceptances, notes, and, for that matter, book accounts—which may themselves be the subject of further security and financing transactions, there arises a host of problems of extreme difficulty. We note their existence without going into particular detail.
is sufficiently protected by his right to the cash proceeds and if he allows those to be dissipated out of current course, he has only himself to blame. That position, however, ignores the fact that the profitable part of the business is in financing the consumer sale, not in financing the dealer, and the argument that the original financer should therefore have at least the opportunity to take over the dealer's chattel paper; furthermore banks, and other subsequent financers, may reasonably be subjected to notice from filing.

Somewhat similar questions come up with respect to the rights of successive financers where the goods subject to lien remain in the borrower's possession. Financer A has advanced $10,000 to Borrower, has duly filed, and has taken a lien on inventory worth $50,000. Borrower wishes to arrange a fresh advance of $10,000 on the same security. If Financer B makes the fresh advance, does he take a lien junior to the lien of the first financer? If so Borrower will have considerable difficulty in arranging for new financing except with Financer A and on such terms as that gentleman may choose to impose. A possible solution to the difficulty would be to allow the first financer the refusal of the new financing: if he declined to make the fresh advance on terms as favorable as those offered by Financer B, then provision should be made for an allocation of a definite part of the inventory to secure the advances made by Financer A, leaving the balance free to secure the fresh advances to be made by Financer B. This would call for a valuation of the inventory before the new financing could be arranged; on the valuation it would appear how much surplus value, over advances already made, there was in the inventory. If the borrower was already financed to the hilt, there would be no free security left to subject to the second lien. If the situation was as assumed above ($10,000 advanced against a $50,000 inventory), the floating character of Financer A's lien could not be used to preclude the borrower from securing further advances from new sources.

Another problem, which has points of similarity with that of the second financer, is that of the attaching creditor. If, for example, the plant and its equipment are mortgaged, and the inventory (together with its proceeds) subject to a financer's lien, what is left for a creditor to attach? The difficulty might be met, at least where the attachments are in aid of relatively small claims, by providing that attaching creditors shall come in ahead of the financer on a certain percentage of cash proceeds received on disposition of the inventory. Where the attachment is in aid of relatively large claims, it would seem necessary that the financer pay up the claim himself or release from his lien enough of the inventory to satisfy the attachment (much as in the case of the second financer) or that the enterprise be administered in bankruptcy.

In financing manufacture and distribution, the secured creditor's nominal right to take possession of his security and sell it to satisfy
his claim is frequently of less practical value to him than his priority in liquidation. If the interests of other parties concerned—borrower and other creditors—are consulted, as well as that of the financer, the traditional power to take and sell appears to be not only an impractical but an unduly drastic procedure. Under our present law a secured creditor, no matter how small his claim, may, on default, move in and cart off the property to which his lien attaches, even though his action may cripple a going enterprise which has perfectly good prospects of pulling through temporary difficulties. Other creditors, unless the situation is one in which they can institute bankruptcy or reorganization proceedings, can do nothing to stop him. Under a security law which validated a floating charge there would, so far as repossession is concerned, be the additional difficulty of determining exactly what goods (or accounts) and how many a repossessing creditor would be entitled to seize.

We believe that a practical alternative can be worked out which will adequately protect the secured creditor without perpetuating legal fiction or subjecting both the enterprise and other creditors to unnecessary jeopardy. A secured creditor should be required to give notice of intention to foreclose to the borrower's other creditors. Objection by a sufficient percentage (perhaps a majority) of adverse claims would suspend the foreclosing creditor's right to remove and sell property claimed subject to his lien. (Such objection not forthcoming he would be privileged to foreclose as under present law.) Objecting creditors would then have a short period within which to satisfy the foreclosing creditor's claim or reach some other amicable arrangement for continuing the enterprise. At the end of the period, if no arrangement had been reached, the enterprise would be administered in bankruptcy or under applicable state insolvency law, the foreclosing creditor receiving the same priorities in distribution that he has under present law.

Under the proposed procedure for lien foreclosure the problem, already mentioned, of current course disposition of the liened goods free of the financer's lien becomes somewhat troublesome, since the right of repossession is to be suspended during a time sufficient for notice to be given other creditors and for such creditors to be heard in objection. Yet, since we propose a lien which will attach to the proceeds, it may be asked how the financer can be harmed by current course disposition—current course meaning at least disposition for a fair price and for new value. The case of the absconding dealer who turns his stock into

59. The mechanics of the notice-giving operation could be worked out along the lines of the Bulk Sales and Bulk Mortgage Acts. Except where the borrower and financer were in collusion to defraud other creditors, it would be to the borrower's interest to give a full list of creditors. Perhaps the collusion case could be solved by giving creditors who have not been notified the power to reclaim the goods or their value from the foreclosing entruster who is unable to prove a good-faith effort to secure a complete list of creditors. At worst, the creditor who is not notified would be as well off as under present law.

60. See the definition of "buyer in the ordinary course of trade," Uniform Trust Receipts Act § 1.
cash on a quick sale and leaves with the cash for parts unknown must not be overlooked. (There is no reason why there should not be absconding manufacturers, but as a class they seem to be less flighty than dealers.) The financer's protection against such shady business today is to take possession of the stock under his lien, if he can. Although it may be that the situation is too infrequent to be worth bothering about, there is no reason why the financer could not be protected against such fraudulent dissipation of his security by providing for the issuance of a temporary restraining order, which would prevent the further disposition of goods subject to the lien until a hearing could be had. Such an order should issue only on a showing of probable cause to suspect fraudulent action by the borrower and should provide for prompt hearing of the issue.

The foregoing procedure sounds more revolutionary than it is. In fact the proposal is substantially one to codify standard business practise; the right to repossess is resorted to today in the case of a going business enterprise only as a last-ditch expedient after other possibilities of arriving at a settlement have been exhausted. The proposal would inhibit the creditor's right of self-help in the occasional case of spite, grudge or unduly hasty action; it would give statutory sanction to the procedure that is customarily followed in the absence of statute. It would regularize an informal procedure, short of judicial reorganization under Chapter X of the Bankruptcy Act, which would be helpful for the smaller enterprise to whose needs the elaborate Chapter X proceeding is not well adapted. Finally, even if—indeed, particularly if—no very radical change in the regular way of doing business is involved, it makes a good deal of sense to write the law in terms of present-day practise and not in terms of behavior patterns now, apart from the exceptional case, a hundred years dead. The business lienor's unqualified right to repossess may well be left to gather dust along with the fictional action of ejectment.

A possible distinction to be taken between manufacturer and dealer is that while the sale of goods by a manufacturer is sale by one professional to other professionals, the sale of goods at retail is by merchant to consumer. The non-professional buyer of goods at retail in current course ought to take the goods free of any financing lien not only despite filing 61 but even if the buyer has actual knowledge of the lien.62

61. As he does under traditional security law, where the goods are held for resale.
62. This goes beyond traditional law. The Uniform Conditional Sales Act §9 provides that filing does not protect against purchasers for value in the ordinary course of business. The Uniform Trust Receipt Act §9(2) (a) provides similarly as to buyers in the ordinary course of trade, who are defined (§1) as acting "in good faith and without actual knowledge of any limitation on the trustee's liberty of sale." But cf. the new-style Factor's Acts, discussed p. 770 supra, in which the current-course buyer takes free of lien whether or not he knows of it, as here proposed.
There is some force in the argument that in transactions between professionals even the current course buyer should be bound, at least by financing arrangements of which he has actual knowledge. To put such a buyer on constructive notice through filing would be an intolerable burden; to subject him to a duty to act with due regard to a financer's interest of which he actually knows is not unreasonable—since due regard would be satisfied if the buyer made payment by check or draft drawn to the joint order of his vendor and the financer. Against such a distinction may be urged first that the financer is already sufficiently protected by having his lien attach to proceeds and second that an act based on actual knowledge introduces issues that can only be determined through litigation. On balance, it seems that the same rule should apply to all current course disposition, whether to consumers or to business men: the current course buyer to take free of any lien against his vendor whether he deals with manufacturer, wholesaler or retailer.

There seems to be no reason to carry over the distinction made in the Uniform Trust Receipts Act between incoming goods and goods already in the borrower's possession—the trust receipt under the Act being available only for incoming goods. The distinction was no doubt a proper one in that Act, since the trust receipt, as commonly used, was a device restricted to financing incoming goods and the Act was not designed to cover the entire field of inventory finance. The proposal made here is, however, comprehensive, as the Trust Receipts Act was not, and the reason for the distinction is no longer valid. The only result of distinguishing between inventory in the borrower's possession at the beginning of the loan period and inventory thereafter acquired would be to require different methods of financing for two stocks of goods which are alike in all respects except the date of acquisition.

(2) Financing Sale of Machinery, Equipment and Fixtures to Commercial and Industrial Users.

This situation differs from the financing of inventory and stock principally in that we are out of floating charge territory. Instead of a shifting mass of goods intended to be sold we have a fixed asset intended to remain in the enterprise during its useful life. The financer's loan will be repaid not out of the proceeds of disposition of liened goods but from the general profits of the enterprise, and the loan period may be a long one.

The peculiar problems of inventory finance, which have burst the seams of traditional security law, are thus no longer present. Another series of no less difficult problems arises in their place. Inventory finance, as a category, makes a reasonably homogeneous whole; there are difficulties, but not insuperable, in drafting a set of rules that will apply satisfactorily over the entire range. Equipment finance, on the
other hand, as we have defined it, runs from the fixtures of beer-taverns
and night-clubs to multi-million dollar obligations arising out of the
acquisition of new rolling stock by railroads. It may be that the pro-
posed category is too broad and should be further subdivided; on the
other hand a legislative line between big and small is a hard one to draw.

On the whole, existing devices have operated fairly well in this field.
In the inventory field none of the existing devices, singly or in combina-
tion, have met manifest financing needs; in equipment finance, the
goods having come to rest, there has been no difficulty in establishing
an effective lien. The substitution of a single financing lien for the
several liens now available seems advisable to simplify the legal struc-
ture; it will not be necessary, however, to introduce any new concept
as radical as that of the floating charge.

The chief complication in the equipment field has been in working
out the financing of new machinery, fixtures or rolling stock in situa-
tions where all the assets of an enterprise are subject to the lien of a
prior real estate mortgage with an after-acquired property clause. On
it is clearly necessary, where the acquisition of new equipment must be
financed, to subordinate the general lien of the prior mortgage to the
special lien on the newly acquired equipment. This necessity has led
to the preponderant use of devices which provide conceptually for the
retention of title to the new equipment in vendor or financer—condi-
tional sales, leases or trust arrangements. It is believed that the new-
equipment lien can be made to prevail without phrasing it in terms of
title theory. The real estate mortgage must be taken into account in de-
ciding on the appropriate filing system; where fixtures and heavy ma-
chinery are concerned, filing will no doubt have to be in conjunction
with real estate recordation, and the simplified system appropriate in
inventory finance will not be adequate.

The modification of the foreclosing creditor’s rights roughly sketched
in our discussion of inventory finance is, if anything, even more appro-

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63. On the operation and construction of the after-acquired property clause, see
Cohen & Gerber, The After-Acquired Property Clause, 87 U. of Pa. L. Rev. 635 (1939); 1
JONES, MORTGAGES §§205 et seq.; §§745, 546 (8th ed. 1928) (collecting cases on the effect
of such a clause on fixtures thereafter acquired). The suggestion in the text that the new
equipment lien should clearly be preferred to the prior lien is not everywhere accepted. See
Note, Defeating the Priority of an After-Acquired Property Clause, 48 HARV. L. REV. 474
(1935), pointing out various abuses in the financing of new equipment.

64. On equipment trust obligations see 1 DEWING, THE FINANCIAL POLICY OF COR-
PORATIONS 205 et seq. (4th ed. 1941). DEWING, id. at 207, estimates that 98% of all
railroad equipment obligations outstanding in 1941 were issued under the so-called Phila-
delphia plan: title to the equipment is transferred from the manufacturer to a trustee,
which then leases the equipment to the railroad, equipment trust certificates being issued
under the deed of trust. The equipment trust, long used almost exclusively by railroads, is
presently coming into favor as a means of financing the purchase of transport planes by
the commercial airlines. Outside the transportation field new equipment financing has made
use principally of the conditional sale, bailment lease and chattel mortgage.
appropriate here than in the inventory field. The practical use to the creditor of his nominal right to repossess and sell is less; the possible damage to the enterprise from the removal of vital fixtures and machinery is greater; the possibility of damage to the equipment lienor from current course disposition of the equipment subject to his lien is practically nil. On all grounds therefore it seems proper to phrase the equipment lienor's rights on default in terms of adjustment with other creditors or priority in liquidation or reorganization and not in terms of self-help.

(3) Financing the sale of goods to individual consumers.

Consumer finance and inventory finance have been the plague spots and trouble breeders of our chattel security law, but for very different reasons. In inventory finance the difficulty is to secure for the financer an effective lien where it is eminently proper that he should have one. In consumer finance the root of the evil is in the inequality in bargaining power between seller and financer on the one hand and consumer-purchaser on the other. No particularly difficult legal problems are involved (the goods are at rest and, since we are out of the business situation, the conflicting equities of adverse creditors do not concern us to nearly the same degree); there remains, however, the immensely difficult and important business of tempering the wind to the shorn lamb.

The principal legal problems are protecting the lienor against subsequent purchasers from the buyer and securing the lienor's rights on default.65

Fortunately we may dismiss from consideration, in our discussion of the subsequent purchaser problems, the case of the automobile. Of all the goods whose sale to the consumer is customarily financed, the automobile is the one which has most frequently raised the problem of fraudulent resale by the buyer. Title certificate legislation, already passed in a good number of states, is the sensible and sufficient solution; such legislation should be, and no doubt soon will be, everywhere adopted.66

65. Two other problems may be disposed of by brief reference. Where the consumer-buyer has a breach of warranty claim against his seller, he should be allowed to assert the claim against the seller's assignee in reduction of any unpaid balance. Affirmative recovery of consequential damages (i.e., personal injury) should however be against the seller alone and not against the assignee. (See discussion of the theoretical availability of such a recovery against the assignee in Part I of this article, 57 YALE L.J. 517, 545). Second, contract clauses purporting to cut off the buyer's defenses against any assignee of the seller or to render the contract itself negotiable (see discussion in Part I, 57 YALE L.J. 517, 544 et seq.) should not be allowed to operate in this field (they are acceptable, or at any rate much less objectionable, in transactions between businessmen). A harder question is presented when the buyer signs a negotiable note in addition to the contract and the note is negotiated to a due-course holder. In such a situation legislation of the Indiana and Maryland type (see p. 773 supra) is particularly useful: the licensing board should be empowered to handle the situation on penalty of revocation of the license.

66. The statutes are not, however, perfect. See Leary, Horse and Buggy Lien Law and Migratory Automobiles, 96 U. of PA. L. REV. 455 (1948). For a collection of cases, see Vold, Cases on Sales 369-409 (1941).
Apart from motor vehicles, most goods sold to consumers on installment payments are household furnishings: furnaces, stoves, refrigerators, washing machines, radios and furniture. Some of these are permanent installations and become in law a part of the realty; others remain movable chattels.

As to the movable chattels, there is unquestionably some risk to the financer that dishonest or necessitous borrowers will attempt to sell them in fraud of the financer’s interest. The risk is believed to be a slight one: the cases, it is true, have not been infrequent, but have almost without exception involved automobiles, which are out of our discussion. Present law protects the financer: the good faith purchaser from the fraudulent conditional vendee or chattel mortgagor is charged with constructive notice under the applicable filing or recordation statute and takes subject to the financer’s lien.

The author’s inclination is to dispense with filing altogether in this situation and cut off the financer’s lien against purchasers from the borrower. Filing makes sense in any business situation, to give notice of existing liens to those who must thereafter determine whether or not to extend credit to the borrower. In the case of movable chattels in the possession of a non-business borrower, it is hard to see that filing makes any sense. The classes of people who may be expected to deal either with the chattel or the borrower on the faith of his ownership of the chattel are three. There are purchasers of the chattel from the borrower: it is institutional in our culture for individuals to sell their old refrigerators or washing machines. There are tradesmen extending current credit to the borrower, grocery bills and the like. There are small loan companies (and to some extent personal loan departments of commercial banks) making loans up to a few hundred dollars.

Since tradesmen’s bills do not purport to be secured, there is no question of protecting the chattel lienor; the tradesman’s decision to extend credit is made either on personal knowledge of his customer or on a report from the local credit bureau, which has more significant sources of information than chattel filing, so that the filing is irrelevant to protect the tradesman. Purchasers from the borrower—who may be other individuals, second-hand stores or merchants taking the old model as a trade-in—are not of the type who consult records; constructive notice provisions merely operate arbitrarily to shift the risk of the borrower’s honesty from the financer to those who deal with the borrower. Small loan companies no doubt are equipped to search the records, but like the tradesmen have more thorough-going sources of information; furthermore there seems to be no good reason in any case for protecting

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67. Such expensive personal adornments as jewelry and fur coats also come to mind.
68. Only where the goods are held for resale does the buyer take free. Contrast Uniform Conditional Sales Act § 5 with § 9.
the small loan company in this situation. The conclusion is that filing on movable chattels sold to consumers be entirely dispensed with, that purchasers from the borrower take free of the financer's interest, but that the financer be protected against the small loan companies and others who may subsequently attempt to acquire a lien on the chattel to secure a loan: a secret lien to this extent seems no threat to the American way of life.

Different considerations apply to chattels which on installation become part of the realty. The only regular way in which such chattels can be disposed of is on sale of the realty to which they are affixed. Since the realty records are always consulted in connection with a real property sale, it is perfectly proper to protect the financer by allowing him to file notice of his lien in those records. The decision as to which chattels become fixtures and which do not should be left to the local law.

As to the financer's rights on default, there is little to suggest that differs from the provisions now found in the Uniform Acts and other non-uniform state legislation. In the case of movable chattels, the financer should be allowed to repossess on default with an accounting for payments made; provision for an impartial valuation of the chattel on repossesson seems preferable to fixing its value by a compulsory resale on notice. In cases where default is occasioned by temporary unemployment, sickness and the like, the right to repossess should be suspended, particularly where a substantial portion of the purchase price has been paid. The special problems of repossessing fixtures are satisfactorily dealt with in Section 7 of the Uniform Conditional Sales Act.

When we go beyond the "legal" problems involved in consumer sale finance to the infinitely more delicate one of seeing that a fair balance is maintained between contracting parties of disparate economic power, we have passed the effective limits of usefulness of a general statute of the type proposed. Recent legislation of the New York type does some good and does nobody any particular harm. The administrative agency approach seems preferable although more cumbersome: licensing those engaged in consumer finance and subjecting licensees to the continuing supervision of a state agency. Any attempt to set down the elements of a fair contract, once and for all, in a statute designed to be permanent seems doomed to failure; there are simply too many ways of skinning a cat.

(4) The Financing of Agricultural Crops and Products.

To a certain extent agricultural finance presents the reverse of the medal from consumer finance. Here too there is frequently a great disparity in bargaining power, but it is typically the buyer and not the
seller who holds the strong hand. If we take only the small farmer into
consideration we have the unique case of a non-professional selling to a
professional business man, instead of the other way around. On the
other hand even the small farmer is far from being as non-professional
in a business sense as the consumer, and state legislatures have been
traditionally attentive to his voice. However, and emphatically, we do
not have only the small farmer to consider; in legislating for the horny-
handed agriculturist we legislate also for the corporate farmer, cultivat-
ing tens of thousands of acres on strictly business and non-bucolic
principles. Add that the long-continued solicitude of the state legisla-
tures has endowed us with a bewildering profusion of special interest
local legislation establishing peculiar rules for crops deemed of particu-
lar importance to the state's economy. Add the emergence of the Fed-
eral Government as a principal source of credit. Add the growing im-
portance of agricultural marketing cooperatives as a favored method
of distribution.

Enough has been said to indicate the peculiar complexities of the
agricultural problem. Of all the situations which have been singled out
as meriting special treatment, agricultural finance is the most difficult.
Both space and knowledge are lacking for more than a cursory indica-
tion of what seem to be the desirable elements of solution. Since the
crops being financed are intended for sale, a lien that will attach to both
crops and proceeds is indicated, current course buyers to take free of
the lien as in the inventory situation. In agriculture the shifting stock
problem, the steady stream of dispositions and replenishments, so im-
portant in inventory finance, is either absent or relatively unimportant,
given the regular rhythm of the crop production cycle. It seems suffi-
cient to allow the financer his lien on the crop presently planted or to
be planted and on the proceeds without allowing it to float, as in the
inventory situation, on to the next crop. Restricting the lien to one
planting will require the parties to execute a new agreement if the
financing arrangement is to be continued, but the requirement seems
to be a reasonable one and not unduly burdensome. A filing system
is clearly necessary and will probably have to be geared to the local
real property records; the same type of general statement proposed
in the inventory situation of intention to engage in financing should
be sufficient. The degree of protection to accrue to the financer on
filing should also be about the same as in the inventory situation. It
is doubtful that the modification of foreclosure rights which we pro-
posed in inventory and equipment finance would be workable here: al-

69. Some of the statutes of this type were discussed briefly in Part I of this article, 57
Yale L. J. 517, 524 at n.17, 535 at n.54 (1948).

70. Under present law filing protects the crop mortgagee. However, under present
law his lien does not attach to the proceeds. It is believed that under the proposal made his
gains and losses balance.
though crop finance resembles inventory finance in that the security is held for sale by the borrower, the resemblance should not be allowed to obscure the fact that a farm is a unique type of enterprise which cannot safely be analogized to an industrial or mercantile one. The author’s present knowledge is insufficient to support an opinion on what modifications, if any, should be embroidered on the traditional foreclosure pattern.

It is hoped the reader will agree that a reorganization of our chattel security law along the lines roughly drawn in the preceding section makes sense. Such a reorganization would be of aid to lenders and borrowers alike. It would aid and simplify the arrangement of needed financing in situations where outworn rules of law make it difficult or impossible for the lender to obtain adequate security. It would sweep away a host of artificial and meaningless legal distinctions between one security “device” and another, in favor of dealing with the parties to a financing transaction on a more factual basis. It would accomplish, that is, what general legislation can; a host of vices and abuses would remain to be dealt with. It would, for example, not purport to check the propensity of the dishonest to engage in fraud, nor to put the weak on an equal bargaining basis with the strong. Such desirable objectives are beyond the scope and reach of a general statute of the type proposed.

It is not the function of code or statute to settle all vexed problems or to provide an automatic answer to new problems as they arise; their function is rather to clear away historical underbrush and to provide counsellors and courts with a freshly marked base line from which to start a new process of case-by-case development. Such a clearing away is long overdue in the field we have been considering; chattel security law is presently such that almost any change will be for the better. And the codifiers will, no doubt, find a sufficiency of material to keep their hands out of mischief for some time to come.