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"My keenest interest is excited, not by what are called great questions and great cases, but by little decisions which the common run of selectors would pass by because they did not deal with the Constitution or a telephone company, yet which have in them the germ of some wider theory, and therefore of some profound interstitial change in the very tissue of the law."—OLIVER WENDELL HOLMES, COLLECTED LEGAL PAPERS (1920) 269.

Comments

TRUST RECEIPTS IN MISSOURI

The more common arrangements for the financing of goods are the consignment, the chattel mortgage, and the conditional sale.

The consignment is one type of bailment. The consignor retains legal title (both beneficially and as security) and the consignee is merely a bailee with authority to sell. The orthodox rule is that a sale, pledge, or mortgage by the bailee even to a bona fide purchaser for value will not cut off legal title. This is clearly demonstrated in the case of *In re Klein*.[1] There a wholesaler agreed to deliver goods to a retailer "on memorandum or consignment," with the right to demand their return on Monday of any week or the option to receive the invoice price, title meanwhile to remain in the wholesaler. The court held that this created a bailment with an option in the wholesaler to convert it into a sale, good as against the retailer's creditors on his bankruptcy, in absence of fraud. The court pointed out that the intention of the parties governs as to whether legal title passed to the retailer and that good faith was the test to apply. The simple consignment imposes no obligation upon the consignor to sell nor upon the consignee to buy (note in the *Klein* case there was no obligation upon the consignee to buy until the consignor exercised his option, at which time it was no longer a consignment but a sale). It merely creates a bailment with a duty on the consignee to account for the goods sold.[2] In a consignment the risk of loss is on the consignor[3] unless otherwise provided for by contract, and the consignee has no interest that he can convey.

At common law the chattel mortgage was a conveyance of legal title and possession by the borrower to the lender. This type of conveyance was later used without the transfer of possession. With the advent of the recording acts, the mortgage that was not accompanied by a transfer of possession was not good as against bona fide purchasers unless the mortgage was recorded. Those mortgages under which the possession remained in the mortgagor came to be considered in some states as a transfer of security interest only to the mortgagee. In the case of a purchase money mortgage, the title shifted from the seller to the buyer-mortgagor who reconveyed an interest to the mortgagee. This interest is a security interest only and the legal title is considered as remaining in the mortgagor. Some states adopt an intermediate theory, title remaining in the mortgagor until default, but shifting to the mortgagee upon default. But regardless of which theory is used the results are usually similar. If the parties contemplate a shift of title to the buyer and a security interest to arise in the seller, the courts will construe the transaction as a purchase money mortgage and subject to the recording acts. The case of *In re Friend*[4] illustrates this proposition. There the agreement was between an unpaid vendor, who under a seller's lien still had possession of the goods sold, and his vendee. It was provided that the vendor had a valid and subsisting lien on the goods, that the goods should be consigned to the vendee for sale of them, and the lien should extend to all monies, accounts, or commercial paper received as a result of sale. Subsequently when the goods were sent to the vendee they were seized by the vendee's creditors. The court held such an agreement when unrecorded was invalid as against third parties. *In re Klein* was decided in 1924 by

1. 3 F. (2d) 375 (C. C. A. 2d, 1924).
2. *In re* Taylor, 46 F. (2d) 326 (E. D. Mich. 1931); Fuller v. Smedley, 48 S. W. (2d) 131 (Mo. App. 1932).
3. Western Rope & Mfg. Co. v. Overland Petroleum Co., 98 Okla. 5, 223 P. 659 (1924).
4. 278 Fed. 153 (C. C. A. 2d, 1921).

the same court which had decided *In re Friend* in 1921. It is illuminating to compare the two cases. Both transactions were substantially the same, yet the court held that one transaction must be recorded, but that the other transaction need not be recorded. The two cases may be distinguished on the ground that in *In re Klein* the wholesaler never parted with legal title, but in *In re Friend,* legal title had passed to the retailer before the purported consignment agreement was entered into. If the wholesaler in *In re Friend* had adopted the simple expedient of rescession, thus revesting title in himself before entering the consignment agreement, recording would not have been necessary. In Missouri such an agreement as that involved in *In re Friend* must be recorded to be protected from attaching creditors.[5]

The conditional sale is a bipartite transaction whereby legal title remains in the seller, and the beneficial ownership and possession passes to the buyer, legal title not passing to the buyer until he satisfies the condition, nominally, payment. Note that the seller and the buyer are dealing direct. At common law the seller's legal title protects him from bona fide purchasers, just as a bailor was protected by his title. Recording was not necessary. In Missouri, however, by statute the seller's interest can be cut off by bona fide purchasers unless the instrument is recorded.[6] In conditional sales a retaking of the goods bars an action on the contract for the deficiency.[7]

The orthodox trust receipt is a tripartite security device whereby the dealer, retailer, or manufacturer buys goods from a distant seller, a third party financial house paying the distant seller and taking title to the goods from the seller as security for advancing the purchase price, but entrusting the buyer with the possession for a limited use necessary to turn them into cash in the course of his business.[8]

The typical situation is as follows: The dealer (retailer or manufacturer) will request his bank to issue a letter of credit authorizing the seller to draw on the bank for the cost of the goods to be sent to the dealer. This is purely routine. At the time when the seller ships the goods to the dealer, beneficial ownership passes to the dealer. If the bill of lading was to the order of the seller he has security title.[9] Then when the seller negotiates the order bill of lading to the financing house and the financing house pays the money, the seller is out of the picture and the financing house has succeeded to his security interest.[10] The next step is the one that is the most technical. The dealer executes a trust receipt stating that title to the goods is to remain in the financing house for security; simultaneously

5. Mo. Rev. Stat. (1939) § 3486.
6. Mo. Rev. Stat. (1939) § 3515.
7. Laclede Power Co. v. Ennis Stationery Co.'s Assigned Estate, 79 Mo. App. 302 (1899).
8. Vold, Sales (1st ed. 1931) § 111. *In re* James, 30 F. (2d) 555 (C. C. A. 2d, 1929); Century Throwing Co. v. Muller, 197 Fed. 252 (C. C. A. 3d, 1912).
9. Williston, Sales (2d ed. 1924) § 284.
10. Vold, Sales (1st ed. 1931) § 112. Bondi v. Holbrook Grocery Co., 96 Vt. 160, 118 Atl. 486 (1922).

the financing house will negotiate the bill of lading to the dealer so that he may obtain the goods from the carrier. The period while the dealer has the order bill of lading is the only time when the dealer can cut off the financing house's interest. Order bills of lading are negotiable and a negotiation, though wrongful, to an innocent purchaser will cut off all interests.[11] But as soon as the dealer surrenders the order bill of lading to the carrier and obtains the goods, the bill of lading is spent and the trust receipt goes into absolute effect and relates back to the giving of the trust receipt. And after this period in the transaction no innocent third party can defeat the financing institution's interest.[12]

In the trust receipt the risk of loss is on the buyer,[13] and the buyer remains personally liable for the money advanced by the financing house[14] even though the financing house retakes the goods. The buyer has an interest he can convey.[15] There is no Missouri recording statute applicable to the trust receipt.[16]

Note the unique characteristics of the trust receipt. In every case there must be a third party financier who has not sold the goods but who has obtained title from someone who was not the borrower. In other words it must be a tripartite arrangement. This tripartite arrangement differs from the ordinary bipartite arrangement in that in the bipartite arrangement there is lacking the third party financial house which obtained its security interest in the above described manner. Clearly neither the consignment, the chattel mortgage, nor the conditional sale fall within the scope of the standard trust receipt, and mere calling of such transactions "trust receipts" will not secure the trust receipt advantages for them.[17]

The consignment is similar to the trust receipt in that neither contemplate the vesting of legal title in the consignee nor the dealer, and both are based on a limited agency theory. The only similarity between the chattel mortgage and the trust receipt is that in the case of a purchase money mortgage possession was never in the buyer prior to the security interest, and the same is true in the trust receipt. Conditional sales and trust receipts are similar in that neither title nor possession was in the buyer prior to obtaining the security interest.

Trust receipts are a comparatively recent development in the law relating to commercial banking and security. Historically they have had a fairly short life.

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11. Commercial Natl. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co., 239 U. S. 520 (1916); *In re* Richheimer, 221 Fed. 16 (C. C. A. 7th, 1915); Arbuthnot, Latham & Co. v. Richheimer & Co., 139 La. 798, 72 So. 251 (1916); Roland M. Baker Co. v. Brown, 214 Mass. 196, 100 N. E. 1025 (1913).

12. *In re* James, 30 F. (2d) 555 (C. C. A. 2d, 1929); *Re* A. E. Fountain, Inc., 282 Fed. 816 (C. C. A. 2d, 1922); Century Throwing Co. v. Muller, 197 Fed. 252 (C. C. A. 3d, 1912).

13. Charavay & Bodkin v. York Silk Mfg. Co., 170 Fed. 819 (C. C. S. D. N. Y. 1909).

14. *Ibid.* Irby v. Cage, Drew & Co., 121 La. 615, 46 So. 670 (1908).

15. Perkins v. Halpren, 257 Pa. 402, 101 Atl. 741 (1917).

16. *In re* Bell Motor Co., 45 F. (2d) 19 (C. C. A. 8th, 1930).

17. Canal-Commercial Trust & Savings Bank v. New Orleans, T. & M. Ry., 161 La. 1051, 109 So. 834 (1926); *Re* A. E. Fountain, 282 Fed. 816 (C. C. A. 2d, 1922); Fletcher American Natl. Bank v. McDermid, 76 Ind. App. 150, 128 N. E. 685 (1920).

Fletcher v. Morey,[18] decided in 1843, resembles the present day trust receipt, and the court allowed the security holder to win on a theory of *equitable lien.* The term "trust receipt" had not at that time become a part of the legal vocabulary. A New York case in 1874[19] dealt with a transaction similar to the present day trust receipt. The plaintiff discounted a draft drawn on the consignee and received a bill of lading with the draft. The consignee refused to pay the draft but obtained the goods by attachment and sold them. The court held that the plaintiff was a *mortgagee in possession* through possession of the bill of lading and was therefore not required to record, and so was entitled to have the amount of the draft out of the proceeds of the property. In 1875 the Supreme Court of the United States in *Dows v. National Exchange Bank of Milwaukee*[20] met a similar problem. There a bank discounted a draft accompanied by a bill of lading and forwarded papers to its correspondent and he in return acknowledged receipt as a warehouseman only. The Court held that a purchaser from the bailee was liable for conversion, saying it was a bailment for *special purposes.* Note that up to this time the name "trust receipt" had never been used by the courts, but that the essential principles concerning this type of transaction had been developed. It is interesting that these very early cases were domestic transactions, for the name of "trust receipt" when it first became common was chiefly associated with importations.

The earliest use of the term "trust receipt" is found in the case of *Barry v. Boninger*,[21] decided in 1876. It was used in connection with the delivery of an importation of sugar to the importer. The court held that the third party bank was the owner and was entitled to the proceeds on the theory that such ownership was acquired under the letter of credit and trust receipt. Two years later in New York[22] a case was decided which involved a domestic shipment of grain and was the typical present day trust receipt situation. The court did not define what the financing house's interest was but did stress the fact that title had come from a source other than the borrower. Then New York had a series of importation cases involving instruments resembling trust receipts[23] but never using those particular words and the court sustained the financing house's interest each time. The first reported case which has been found in New York in which the term "trust receipt" is used is *English Bank of Rio de Janeiro v. Barr*[24] and was in accord with the previous New York cases. From that time on the term "trust receipt" has been definitely applied to importation cases and the courts have consistently protected the financing house's interest. Domestic transactions were being protected at the same time under similar circumstances, but just when they began also to be termed "trust receipts" is not altogether clear. But in 1922, Judge

18. 2 Story 555, 9 Fed. Cas. No. 4,864, at 266 (C. C. Mass. 1843).
19. First National Bank v. Kelly, 57 N. Y. 34 (1874).
20. 91 U. S. 618 (1875).
21. 46 Md. 59 (1876).
22. Farmers & Mechanics' Natl. Bank v. Logan, 74 N. Y. 568 (1878).
23. Carter v. Arguimbau, 31 Abb. N. C. 3 (N. Y. 1884); Moors v. Kidder, 106 N. Y. 32, 12 N. E. 818 (1887).
24. 31 Abb. N. C. 7 (N. Y. 1888).

Augustus N. Hand wrote an opinion in the case of *In re A. E. Fountain, Inc.*,[25] which definitely brought domestic tripartite transactions under the name of "trust receipts." The courts have almost unanimously protected the banking house's interest under the trust receipt, but they have had trouble at times expressing just what that interest was. For example, in the case of *General Motors Acceptance Corporation v. Hupfer*[26] the court said that until compliance with the terms of the trust receipt the dealer was a bailee and no more. The point decided in the case, that the trust receipt arrangement was not a conditional sale or chattel mortgage and therefore did not fall within the local recording acts, seems correct. It seems unfortunate to rest that correct result on the indefinite ground that the trust receipt arrangement is a mere bailment and nothing more.[27]

Missouri has had the trust receipt problem before its courts only twice so far as this writer could ascertain. The first case, *In re Bell Motor Co.*,[28] arose in the District Court of the United States for the Western District of Missouri. There the court allowed the Industrial Acceptance Corporation to recover cars sent to the bankrupt by the Studebaker Corporation. The Acceptance Corporation had taken title from Studebaker Corporation and had taken the bankrupt's trust receipt for the cars. The district court was upheld by the circuit court of appeals, that court pointing out that there was no good reason why the principles of trust receipts should not apply to the domestic transactions as well as to importations.

The second case, *Globe Securities Co. v. Gardner Motor Co.*,[29] gives us trouble. The Gardner Motor Company, a manufacturer of automobiles, delivered products of its factories to the Motor Brokerage Company under a so-called trust receipt. The Brokerage Company gave the Globe Securities Company, the plaintiff, a chattel mortgage on the cars without the consent of the Gardner Motor Company. The Gardner Motor Company, upon its first information of the existence of the chattel mortgage, asserted its ownership and took the automobiles to its factory in St. Louis and retained them against plaintiff's demand for the cars. The Missouri Supreme Court held that the Gardner Motor Company, the holder of the trust receipt, should retain the goods.

It is important to note that this was a bipartite agreement. There is no third party financing house. The transaction was strictly one between the Gardner Motor Company and the Motor Brokerage Company. The Globe Securities Company was in the position of an innocent purchaser. It is clear that this transaction did not constitute an orthodox tripartite trust receipt. It is not intended here to cast any doubt as to the correctness of the final result reached in this particular case; for clearly the transaction was one of consignment regardless of the fact that the parties denominated the instrument involved here as a "trust receipt," and the result can be sustained on that theory. The dealer bound himself in no way to

25. 282 Fed. 816 (C. C. A. 2d, 1922).
26. 113 Neb. 228, 202 N. W. 627 (1925).
27. See notes 13 and 15, *supra*.
28. 45 F. (2d) 19 (C. C. A. 8th, 1930).
29. 337 Mo. 177, 85 S. W. (2d) 561 (1935).

pay for the goods so the transaction could not be a conditional sale. It may be that the Gardner Motor Company was attempting to throw the risk of loss on the Brokerage Company when they denominated the instrument "trust receipt," and still put enough of the characteristics of the consignment in it so as to have a greater degree of control over the cars than a conditional sale or chattel mortgage would have given them, and to eliminate the necessity for recording.

But it is difficult to tell exactly how the Missouri Supreme Court reached its decision. The court talked both of trust receipts and of consignment and indiscriminately cited cases from both situations to sustain its finding. The opinion raises three questions: (1) did the court find there was an enforceable trust receipt, (2) did they find it was a consignment and not a trust receipt, (3) or did they find there was no difference between consignments and trust receipts?

The court after quoting at considerable length from *Ruling Case Law* on the characteristics of consignment as differing from the conditional sale, but never tying these principles to the facts of the *Gardner* case, states: "In the case of a trust receipt, title has never been taken in the debtor, and consequently he cannot convey such title back to the holder of the trust receipt . . . the title remains in the party secured, while the possession is intrusted to one who has a certain interest as yet indefinite in the property," and cites *In re James*.[30] The court seemed to infer that the essential thing to a trust receipt was that the buyer must never have had the title and cites the *James* case. Now the *James* case restricted a trust receipt much more than the Missouri Supreme Court said it did. That case involved the orthodox tripartite arrangement, and in it the Circuit Court of Appeals, Second Circuit, states and holds: "The holder of a trust receipt, if he derives his security title from a person other than the one responsible for the satisfaction of the obligation which the party secures, is not obliged to file his security as is required in the case of chattel mortgages." The Missouri Supreme Court says *"remains in the party secured,"* whereas the Circuit Court of Appeals, Second Circuit, says, *"if he derives his security from a person other than the one responsible for the satisfaction of the obligation."* The Missouri Supreme Court's definition would include bipartite agreements, but apparently the court did not consider this point. There is a great deal of difference between reserving security interest and deriving security interest. The *James* case is not authority for calling the transaction in the *Gardner* case a trust receipt. The court in the *Gardner* case seems to come to the conclusion that it was a case of consignment because the Sales Company had not obligated itself either to buy or secure the purchase in any way, and cited the cases of *Sturm v. Boker*[31] and *In re Taylor*.[32] These cases are proper authorities for a consignment theory. But by way of closing, the court cited a series of cases[33] all of which were consignment cases except the *Bell* case

30. 30 F. (2d) 555 (C. C. A. 2d, 1929).
31. 150 U. S. 312 (1893).
32. 46 F. (2d) 326 (E. D. Mich. 1931).
33. Sturm v. Boker, 150 U. S. 312 (1893); *In re* Bell Motor Co., 45 F. (2d) 19 (C. C. A. 8th, 1930); *In re* Columbus Buggy Co., 143 Fed. 859 (C. C. A. 8th,

already discussed. Now from these indiscriminate citations the court seemed to indicate that it made no difference whether the transaction was that of a trust receipt or of a consignment. This was no doubt true in the facts of the particular case, but the court went further and said the principal case was similar to the *Bell* case. The *Gardner* suit was a bipartite transaction while the *Bell* case was a tripartite agreement.

It is essential that these concepts should be kept clear and distinct. It is not beyond the realm of probability for a situation to come up in which it would make a great deal of difference which concept is used. Suppose the goods were destroyed while they were in the hands of the retailer. If the transaction is one of consignment the risk will fall on the consignor,[34] but if it is a trust receipt it will be on the buyer.[35] Or suppose that the goods were retaken and sold at a loss or profit. If it is a consignment the consignor bears the loss or gets the profits,[36] while if it is a trust receipt the buyer is personally liable for the shortage[37] and also get any excess from the sale.[38]

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1906); Kingman Plow Co. v. Joyce, 194 Mo. App. 367, 184 S. W. 490 (1916); Packard Piano Co. v. Williams, 167 Mo. App. 515, 151 S. W. 211 (1912); Ferd Heim Brewing Co. v. Linck, 51 Mo. App. 478 (1892); Cable Co. v. Elliott, 203 S. W. 211 (Mo. App. 1918).

34. Western Rope & Mfg. Co. v. Overland Petroleum Co., 98 Okla. 5, 223 Pac. 659 (1924).

35. See note 13, *supra.*

36. *In re* Taylor, 46 F. (2d) 326 (E. D. Mich. 1931); Fuller v. Smedley, 48 S. W. (2d) 131 (Mo. App. 1932).

37. See note 13, *supra.* Irby v. Cage, Drew & Co., 121 La. 615, 46 So. 670 (1908).

38. Gerseta Corporation v. Equitable Trust Co. of N. Y., 241 N. Y. 418, 150 N. E. 501 (1926).