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UNRECORDED CONDITIONAL SALE—TIME OF BUYER'S CREDITOR'S RELIANCE

*Friedman v. Sterling Refrigerator Co.*¹

During December, 1937 B established a line of credit and began a running account with C. A day or two prior to February 11, 1938, B ordered by telephone from C merchandise in the amount of \$14.23. February 11, 1938, S claimant-appellee delivered a refrigerator case to B under the terms of a conventional conditional sale contract. February 12, 1938, the merchandise which B ordered from C was delivered to B. February 17, 1938, the contract of conditional sale was recorded. September 27, 1938, petition putting B into bankruptcy was filed. C filed a claim in bankruptcy in a total amount of \$164.73, for balance due on deliveries of merchandise between December 16, 1938 and February 22, 1938, on which, however, there was only one delivery (\$14.23 above) between February 11 and February 17. Of the total purchase price of the refrigerator case of \$786.25, there remained due S at the time of bankruptcy \$534.25. S filed a claim for repossession of the refrigerator case, and this was opposed by appellant, who is the trustee in bankruptcy, on the theory that C, who is claiming in bankruptcy, is a subsequent creditor who became such between the time of the delivery of the refrigerator case and the date of the recording of the contract of conditional sale, so that under the Maryland statute² requiring recordation of a conditional sales contract

¹ 104 Fed. (2d) 837 (C. C. A. 4th, 1939).

² Md. Code Supp. (1935) Art. 21, Sec. 55:

"Every note, sale or contract for the sale of goods and chattels, wherein the title thereto, or a lien thereon, is reserved until the same be paid in whole or in part, or the transfer of title is made to depend upon any condition therein expressed and possession is to be delivered to the vendee, shall, in respect to such reservation and condition, be void as to third parties without notice until such note, sale or contract be in writing, signed by the vendee, and be recorded in the Clerk's office of the Superior Court of Baltimore City, or in the Clerk's office of the Circuit Courts of the various counties, as the case may be, where the vendee resides, or in the case of a corporate or partnership vendee, then where such vendee has its principal place of business in the State of Maryland; and such recording shall be sufficient to give actual or constructive notice to third parties when a memorandum of the paper writing signed by the vendee or vendees, setting forth the date thereof, the amount due thereon, when and how payable and a brief description of the goods and chattels therein mentioned shall have been recorded with the Clerk aforesaid, but it shall not be necessary that said paper writing shall be acknowledged or an affidavit made to the consideration therein expressed as in the case of bills of sale."

C (because of S's failure to record) is protected and should have priority over the claim of conditional vendor. The District Court held that within the contemplation of the recording statute as construed by the Maryland Court of Appeals, C was a prior creditor and allowed S to recover the refrigerator case from the bankrupt estate.³ On an appeal to the Circuit Court of Appeals by the trustee in bankruptcy the decree of the lower court was reversed.

If the contract between B and C for merchandise and the delivery of the merchandise were both made *after* the installation of the refrigerator case and before recording of the contract of conditional sale, then there would seem to be little doubt that under Federal decisions and their construction of the Maryland law the merchandise creditor should prevail as against the conditional vendor.⁴ The Court in its opinion indicates that there was nothing in the facts of the case under discussion to show that the delivery of the merchandise was not the act evidencing acceptance, which meant the contract was made after the installation of the refrigerator case.

On the other hand, if the contract between B and C for merchandise and the delivery of the merchandise were both made *before* the installation of the refrigerator case then there would likewise seem to be little doubt that the conditional vendor would prevail, because of the rule that the recording statutes are only for the protection of subsequent creditors, which rule was enunciated in *Gunby v. Motor Truck Corp.*⁵

But, if the contract between B and C for merchandise were made before the installation of the refrigerator case and the merchandise were delivered in the interim between the installation of the refrigerator case and the recording of the contract of conditional sale then we have a situation which apparently heretofore has not been passed upon in construing the Maryland statute (except with possibly one incidental exception to which reference is made below). Research fails to reveal any decisions in other jurisdictions on this point. Even if such decisions were available they would be of little assistance as authority because the recording statutes of different states vary in

³ In re Wilhelm, 25 Fed. Supp. 440 (D. C. Md. 1933).

⁴ In re Rosen, 23 Fed. (2d) 687 (D. C. Md. 1928); In re Shipley, 24 Fed. (2d) 991, 83 A. L. R. 1288 (D. C. Md. 1928); Enterprise Fuel Co. v. Jones, 99 Fed. (2d) 928 (C. C. A. 4th, 1938); Arnold, *Conditional Sales of Chattels in Maryland* (1937) 1 Md. L. Rev. 187, 199 *et seq.*

⁵ 156 Md. 19, 142 A. 596 (1928); Arnold, *supra* n. 4, 198 *et seq.*

their provisions and in the way in which they should be construed. Text writers, also, apparently have not considered this particular problem.

That a complete contract was made when B ordered the merchandise over the telephone from C may well have been the actual situation in the case under discussion. The Court does not indicate with certainty just when the contract was made because in view of its decision it considered this determination as immaterial. The Circuit Court of Appeals said:

“The learned judge below held to the contrary, on the theory that the crucial date in determining the status of the creditor was that on which the credit was agreed upon rather than that upon which the goods were delivered; but we find no authority for such distinction and we do not think it sound. The creditor’s claim for goods sold and delivered, which is the claim upon which he relies, does not arise until the delivery of the goods; and, in making the delivery upon which such claim arises and parting with title to the goods delivered, he is a ‘third person without notice’, whom it was the purpose of the statute to protect. The fact that delivery may have been made in accordance with a pre-existing contract is immaterial; for, notwithstanding such contract the seller could protect himself, if doubtful of the solvency of the purchaser, by refusing delivery or asserting a seller’s lien. See Williston on Sales, pp. 879-883. Only upon delivery does he lose power to protect himself with respect to the goods sold, and it is clear that his status as a creditor, entitled to protection under the statute, must be judged as of that date. It does not appear in this case, however, that delivery was made under a pre-existing contract. It is true that an order for the goods was telephoned to the creditor two or three days before their delivery; but there is nothing to show that it resulted in a binding contract of sale until acceptance was evidenced by delivery. The fact that a line of credit had been established prior thereto is immaterial, as the creditor could have ceased furnishing goods under the line of credit at any time. It was likewise immaterial that there was a running account between the parties; for each order for goods became a separate and independent contract when ac-

cepted, and, with respect to the conveyance, the seller became a subsequent creditor as to items delivered after its execution. . . ."

This view of making the decisive date the time of delivery and not the time the contract is made raises some very interesting questions. For example, B, as vendee, is in possession of a valuable chattel under a conditional sale contract which is unrecorded. C, without any actual knowledge of the conditional sales contract, makes a contract with B agreeing to deliver goods to B in thirty days. After this contract is made, but before delivery, S, the conditional vendor, records the contract so that at the time of delivery C has constructive notice. In a contest between C and S, who will prevail? If the time of delivery is the decisive date, clearly S should. If S prevails, then it would seem that C has the onerous duty of searching the records at the time the contract is made to see if he will enter into the contract giving credit, and again at the time of delivery if he is to be very cautious. Or suppose after the contract is made between B and C, but before delivery, C learns of the recordation, would C be justified in refusing performance on the ground that he entered into the contract giving credit in reliance on the chattel, there being no evidence at delivery date of B's insolvency? Another example, what will be the result if under a contract between B and C the latter is to make delivery in installments and S records after delivery of the first installment? Will S prevail over C as to subsequent deliveries and if so, does it not make it incumbent on C to search the records before delivery of each installment? This might not be a troublesome problem in bankruptcy,⁶ but it well might

⁶ The Court in its opinion referred to the bankruptcy rule that when under Secs. 67a and 70e of the Bankruptcy Act of 1898, as amended (under the Chandler Act merged in Sec. 70e), claims, which for want of record are not valid liens as against claims of certain creditors of the bankrupt, are not liens against the estate; or when the trustee avoids any transfer by the bankrupt which any creditor might have avoided, then a lien or transfer which is void as against one or some creditors, but not all of the creditors of the bankrupt, may be avoided in toto by the trustee in bankruptcy for the benefit of all the creditors claiming in bankruptcy. *Moore v. Bay*, 284 U. S. 4, 76 L. Ed. 133, 52 S. Ct. 3, 76 A. L. R. 1198 (1931); *In re Moore*, 11 Fed. (2d) 62 (C. C. A. 4th, 1926); *In re Rosen*, 23 Fed. (2d) 687 (D. C. Md. 1928). That this rule sometimes occasions what is tantamount to a windfall for all the creditors claiming in bankruptcy is well illustrated by the principal case under discussion where because one creditor with a claim of only \$14.23 could attack the conditional vendor's lien the bankrupt estate was able to recover an asset worth several hundred dollars for the benefit of all the creditors

be if C issues an ordinary execution. Another example, while B is in possession of a chattel under an unrecorded contract of conditional sale C enters into a contract to supply work and labor which will require several weeks to perform. The day after C starts work S records the contract. Will S be protected as against C for any claims arising out of C's labor subsequent to recordation, and if so, does it not make it incumbent on C to search the records each day before starting work?

While it may be true that "the seller could protect himself, if doubtful of the solvency of the purchaser, by refusing delivery or asserting a seller's lien", it would seem to be more in accord with the realities of the situation to assume that the seller has already satisfied himself as to the buyer's solvency at the time the contract selling the merchandise on credit is made. Subsequent insolvency or bankruptcy of the buyer is probably the rare exception and not the rule, and even if it does ensue it may not develop for weeks or months after the creditor has delivered his merchandise. And certainly it would seem that if the contract giving credit has been made, the seller of the merchandise would not be justified in refusing performance merely because the buyer does not subsequently acquire possession of a chattel under an unrecorded con-

even though the latter, in the absence of bankruptcy, could not have attacked the validity of this lien. While this rule may be supported on the ground of convenience in administering the bankrupt estate, to some persons it may seem most inequitable.

It would seem that the conditional vendor, after the filing of the petition in bankruptcy, cannot protect his lien by paying off the claim of the creditor and thereby eliminate the basis on which the lien is avoided. The Supreme Court, in *Bailey v. Baker Ice Machine Co.*, 239 U. S. 268, 275, 60 L. Ed. 275, 286, 36 S. Ct. 50, 54 (1915), has said: "When not otherwise specially provided, the rights, remedies, and powers of the trustee are determined with reference to the conditions existing when the petition is filed. It is then that the bankruptcy proceeding is initiated, that the hands of the bankrupt and of his creditors are stayed, and that his estate passes actually or potentially into the control of the bankruptcy court."

It is quite possible that such a payment might be treated as a crime under Sec. 29b of the Bankruptcy Act which provides: "A person shall be punished by imprisonment for a period of not to exceed five years or by a fine of not more than \$5,000, or both, upon conviction of the offense of having knowingly and fraudulently . . . (5) received or attempted to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof from any person, for acting or forbearing to act in any proceeding under this Act." Sec. 1 (23) of the Bankruptcy Act provides "'Persons' . . . when used with reference to the commission of acts which are forbidden under this Act shall include persons who are participants in the forbidden acts. . . ."

The conditional vendor's solution to all these difficulties is, as suggested by the Court in the principal case, prompt recording.

tract of conditional sale of which the seller knew nothing at the time the contract was made and if the seller refused performance on such grounds he would subject himself to damages for breach of contract.

Perhaps there is a clew to what construction the Court of Appeals may give to the Maryland recording statute in the event that it is appealed to to decide a case similar to the one under discussion. In *Gunby v. Motor Truck Corp.*⁷ certain creditors of a conditional vendee sought to execute on a truck of which the vendee was in possession under an unrecorded contract of conditional sale. The Court of Appeals ruled that the creditors were pre-existing creditors and hence could not prevail over the conditional vendor and at the end of the opinion the Court said this:

“Nor can we accede to the view of appellants (creditors), strongly pressed, that because defendants (creditors) permitted interest to accrue, or the debts to remain uncollected, after the date of the contract of sale, their claims were thereby taken out of the class of pre-existing debts.”

There would seem to be some analogy between a contract for the purchase of goods before the conditional sale, with delivery after the conditional sale, and the incurring of a debt before the conditional sale, with the creditor permitting the debt to run on with interest accruing after the conditional sale.

In conclusion, it would seem that having only one decisive date to determine whether or not a creditor of the conditional vendee is to have priority over a conditional vendor, and making this decisive date the day the contract is made between the conditional vendee and the creditor and not the day of performance by the creditor, would tend toward greater certainty and less confusion.

⁷ *Supra* n. 5.