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Holder of a Conditional Sales Contract as an "Encumbrancer" Within the Meaning of Recording Statutes - Automobile Accep. Corp. v. Universal Corp

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Holder Of A Conditional Sales Contract As An "Encumbrancer" Within The Meaning Of Recording Statutes

Automobile Accep. Corp. v. Universal Corp.[1]

On July 5, 1955, Suburban Nash, Inc. sold by contract of conditional sale an automobile to Thomas, and he on that date took possession of the auto. On the same day Suburban Nash assigned the contract to appellee, Universal C.I.T. Credit Corporation. The following day, Suburban Nash induced Thomas to execute a second conditional sales contract covering the same auto. This contract, together with a duplicate title to the auto obtained fraudulently from the Commissioner of Motor Vehicles, was immediately assigned to appellant, Automobile Acceptance Corporation. Neither contract was recorded until seven months later when Suburban Nash was in financial difficulties. Then, Auto Acceptance recorded its contract first, and C.I.T. recorded three days later.

C.I.T. brought this suit seeking a declaratory judgment or decree establishing the superiority of its claim over that of Auto Acceptance.

The Circuit Court found that Section 2 of Article 8 of The Code of 1951[2] relating to assignments of accounts receivable or contracts with or without notification to the debtor of the assignment was controlling, and therefore gave a decree for C.I.T. The Court of Appeals reversed by a 3-2 decision. The majority of the Court of Appeals rejected the assignment statute as controlling, but found

[1] 216 Md. 344, 139 A. 2d 683 (1958).
[2] Now 1 Md. Code (1957) Art. 8, §1.

rather that Section 74 of Article 21 of the Code of 1951[3] pertaining to recording of conditional sales contracts, was applicable. Since the holder of the second contract recorded first, he should prevail. In order to do this the majority had to find that the holder of a conditional contract of sale was an incumbrancer within the meaning of the recording statute.

The dissent did not agree that the holder of a conditional sales contract was an incumbrancer within the meaning of the statute, and therefore would not apply it.

The majority pointed out that the act concerning assignments of accounts receivable[4] was apparently passed to cover a situation such as that in *Corn Exchange Bank v. Klauder*.[5] There, an assignment made under the non-notification plan was set aside as preferential under the bankruptcy act.[6] The important date under the bankruptcy act was the time when a transfer became perfected as against a *bona fide* purchaser or a creditor. In states, such as Pennsylvania, where the *Klauder* case arose, and in Maryland, it was necessary to give the debtor notice of the assignment to perfect it. Therefore, under a non-notification plan of assignment of accounts receivable, the assignee would never perfect his claim prior to the bankruptcy of the assignor.[7]

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[3] NOW 2 MD. CODE (1957) Art. 21, §66.

[4] *Supra*, n. 2. In pertinent part:
"All written assignments, and all written assignments in the nature of a pledge, of accounts receivable and amounts due or to become due on open accounts or contracts, except in cases where notice to the debtor of such assignment is specifically required by any policy of insurance or a statute then in effect, shall be valid and legal and shall pass the title of such accounts receivable and amounts due or to become due on open accounts or contracts to the assignee thereof, and shall take effect according to the terms of the assignment, without the necessity of notice to the debtor, and the transfer of the title shall take effect and be valid and enforcible against all persons as of the date thereof; . . . ."

[5] 318 U.S. 434, 144 A.L.R. 1189 (1943).

[6] ¶60 (a), (b) as amended June 22, 1938; 11 U.S.C.A. (1943) §96 (a), (b).

[7] As authority that in Maryland to protect one's assignment against a subsequent assignee, the assignee must have first given notice to the debtor the Court cites Lambert v. Morgan, 110 Md. 1, 72 A. 407 (1909). Compare this situation with that of the claim of a prior assignee against that of a subsequent attaching creditor. See McDowell, Pyle & Co. v. Hopfield, 148 Md. 84, 128 A. 742, 52 A.L.R. 105 (1925); and also Seymour v. Finance & Guaranty Co., 155 Md. 514, 531, 142 A. 710 (1928). These cases illustrate that except under the preference provision of the Bankruptcy Act of 1938 any assignee has a right superior to that of a general creditor. For a discussion of these cases see Page, *Latent Equities in Maryland*, 1 Md. L. Rev. 1, 19-25 (1936).

Within two months after the *Klauder* case the Maryland General Assembly passed the statute doing away with the requirement of notice to perfect an assignment of accounts receivable or of money due under a contract.[8] This section was meant "to validate assignments of accounts receivable against third parties without notification of the debtor."[9]

It was not until 1955 that this statute was first cited in a case.[10] The Court of Appeals of Maryland said that probably the statute was meant to change the law only to the extent of dispensing with notice as a requirement for " 'perfecting' " claims against a subsequent trustee in bankruptcy of the assignor. It held that "notice may still be a factor in determining priorities as between the various parties or claimants . . . ."[11] This language severely limits the scope of the statute and would seem to justify the court's refusal in the present case to hold the assignment statute controlling.[12]

After their discussion and a finding that the assignment of accounts receivable act was not controlling, the majority turned its attention to the recording statute.[13] The recognized purpose of this statute was to protect against secret liens created by retention of title after delivery of possession.[14] In Maryland, prior to the first recording statute, passed in 1916, conditional sales contracts were held valid against creditors as well as between the parties; but they were held not valid against *bona fide* purchasers for value

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[8] *Supra*, n. 2. See also Arnold, *The 1950 Amendment to the Preference Section of the Bankruptcy Act and Maryland Law*, 14 Md. L. Rev. 311 (1954).

[9] Arnold, *op. cit. ibid.*, 314.

[10] Md. Coop. Milk Producers v. Bell, 206 Md. 168, 110 A. 2d 661 (1955).

[11] *Ibid.*, 177.

[12] To date there are no other reported cases where this statute has been cited.

[13] 2 Md. Code (1957) Art. 21, §66:

> "Every . . . 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 subsequent purchasers, mortgagees, incumbrancers, . . . until such . . . contract be in writing, signed by the vendee and be recorded . . . . Such recording shall be sufficient to give actual or constructive notice to such 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, ..."

[14] Tatelbaum v. Nat'l. Store Etc. Co., 196 Md. 599, 606, 78 A. 2d 228 (1951). This case contains an excellent discussion of the history of the conditional sales recording statute.

without notice.[15] The 1916 act attempted to protect third persons without notice from contracts of conditional sales that were not recorded.[16] This broad language offered protection to anyone who acted without notice and would be injured by enforcement of the conditional sales contract.[17] In 1949 the legislature amended the act so as to strike out the phrase "third persons without notice" and substitute certain designated classes.[18]

In 1954 the Court of Appeals was asked to include among those protected by the statute, creditors in a case involving a general assignment for benefit of creditors.[19] It was argued that this should be done since receivers were included within the statute and trustees under a general assignment, being very similar, should also be included. The court, however, noted the differences between the two, and refused to extend coverage to one whom the legislature chose not to cover. The Court again chose not to allow recording to be a bar to recovery in *Mohr v. Sands*,[20] where it was held that recording was not sufficient to give constructive notice when possession of the chattel had not passed from the vendor to the vendee.

Where the parties have brought themselves properly within the terms of the statute the reservation of title by the conditional vendor has been upheld.[21] In the present case the Court considered the important question to be the effect of the recording statute on the rights of the con-

[15] Praeger v. Implement Co., 122 Md. 303, 89 A. 501 (1914); Hall v. Hinks, 21 Md. 406 (1864); Lincoln v. Quynn, 68 Md. 299, 11 A. 848 (1888); Tatlebaum v. Pantex Mfg. Corp., 204 Md. 360, 104 A. 2d 813 (1954).

[16] MD. LAWS 1916, ch. 355.

[17] Roberts & Co. v. Robinson, 141 Md. 37, 43-44, 118 A. 198 (1922).

[18] MD. LAWS 1949, ch. 430:

". . . as to subsequent purchasers, mortgagees, incumbrancers, landlords with liens, pledgees, receivers, and creditors who acquired a lien by judicial proceedings on such goods and chattels without notice . . . ."

[19] Tatelbaum v. Pantex Mfg. Corp., *supra*, n. 15.

[20] 213 Md. 206, 131 A. 2d 732 (1957), noted in 19 Md. L. Rev. 78 (1959). This case involved virtually the same parties as those involved in the case presently under discussion, and also was brought about by the fraudulent dealings of the Suburban Nash Company. The Company sold an auto to Mrs. Mohr, by contract of conditional sale, which was assigned to Universal C.I.T. and was duly recorded. Mrs. Mohr did not take the auto herself, but allowed her ex-husband, a salesman for Suburban Nash, to keep it. The auto was used as a demonstrator, and was eventually sold to Sands, also by conditional sales contract. This contract was assigned to Auto Acceptance Corp. and it too was properly recorded. After the bankruptcy of Suburban Nash, Mrs. Mohr and C.I.T. brought suit to establish the superiority of their respective claims.

[21] Gunby v. Motor Truck Corp., 156 Md. 19, 142 A. 596 (1928); Goldenberg v. Finance & Credit Co., 150 Md. 298, 133 A. 59 (1926); Finance Etc. Co. v. Truck Co., 145 Md. 94, 125 A. 585 (1924).

ditional vendor and pointed out that the purpose of recording is to protect against secret liens.[22]

Thus the principal issue in this case was whether the appellant fell within the protected classes. No longer does the recording statute protect the broad class of "third persons without notice" as did the old statutes. Under the 1949 amendment only certain designated classes were to be protected, and the obvious intent of that statute was to limit the class.[23] The majority of the Court found that the holder of a conditional sales contract held a lien and therefore was an incumbrancer, and protected under the statute. The minority dissented on this point. They argued that the holder of a conditional sales contract holds title, and as such could not hold a lien.

It is true that from the very terms of a conditional contract of sale the vendor retains legal title. But that title is kept only for the purpose of securing the payment of the purchase price. "It could have no other purpose . . ."[24] It is kept for purposes of security.[25] If such is the case, then it appears that a conditional vendor does retain a lien, and many states have so held.[26]

A federal case, arising in Maryland, said that the seller retains an interest, referred to as a "security title", but the buyer gets the beneficial title.[27] The majority cites no case as primary authority for their finding that the conditional vendor is an incumbrancer under Maryland law. Rather, the majority opinion goes about the problem by way of analogy. It cites the Motor Vehicle statute[28] and the Maryland Retail Installment Sales Act,[29] with the intimations contained therein that the holder of a legal title may have a lien. The majority also notes that they believe that their finding that a conditional vendor has a lien is in accord with general business understanding. This

[22] *Supra*, n. 1, 357.

[23] The dissent points out in their opinion that the 1949 amendment was brought about at the instance of the large credit companies, *supra*, n. 1, *dis. op.* 360, 362.

[24] 3 JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES (6th ed. 1933) 312.

[25] *Op. cit. ibid.*, §1242.

[26] *Op. cit. supra*, n. 24, §1242 and cases cited. It should be noted that in this same section it is said that other states hold that more than a lien is retained. Just how much more is not clear. No Maryland cases are cited one way or the other. The decision of the majority in the present case would seem to put Maryland with those states that hold to the lien theory.

[27] In re Imperial Brewing Co., 127 F. 2d 766, 769 (4th Cir. 1942).

[28] 6 MD. CODE (1957) Art. 66½.

[29] 7 MD. CODE (1957) Art. 83, §§128-153.

is probably true and would be a strong justification for the court's deciding as it did.

In support of their argument the minority cited *inter alia* the case of *Westinghouse v. State Tax Comm.*[30] Westinghouse claimed that the government had title to goods manufactured by them for the government and so the goods were immune from state taxation. The Court, however, said Westinghouse had legal title and so the goods were taxable. At this point the Court said that one could not have a lien on goods to which they held title.[31] The Court, in the *Westinghouse* case, distinguished that case from an earlier one where a naked legal title was not taxed because the equitable title was in the Federal government.[32] It would seem then that the statement of the Court in the *Westinghouse* case was not meant to apply to naked legal titles. The dissent also cited other cases that have held in various situations that the conditional vendor holds title and that the conditional vendee had only a right to possession of the goods with a right to gain title on fulfillment of the conditions of the contract.[33]

Probably the majority reached a better decision, at least from the standpoint of public policy. If the assignment statute had been held controlling, an assignee could never be sure of protecting himself. At times some hardship may be caused as a result of enforcement of the recording statute, but protection may be had by timely recordation. By failing to record a creditor subjects himself to a possibility of loss.[34]

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[30] 206 Md. 392, 111 A. 2d 661 (1955).

[31] *Ibid.*, 402.

[32] Hopkins Univ. v. County Commrs., 185 Md. 614, 620, 45 A. 2d 747 (1946).

[33] In re Lake's Laundry, 79 F. 2d 326, 328 (2nd Cir. 1935), *cert. den.* 296 U.S. 622 (1935), where a distinction was made between a conditional vendor and a mortgagee. Dissenting, Judge Learned Hand called the distinction a barren one; *dis. op.* 328. Stern Co. of Washington v. Rosenberg, 89 F. 2d 843 (D.C. Cir. 1937); court refused to allow a landlord to attach goods sold to tenant by conditional sales contract. See also State Bank v. Johnson, 104 Wash. 550, 177 P. 340, 3 A.L.R. 235 (1918), where the fact situation is somewhat similar to the present case. The Court *held* that the assignment by the conditional vendor of his contract divested him of all he had, and a subsequent sale by him of the same chattel transferred nothing to the second vendee.

[34] See Friedman v. Sterling Refrigerator Co., 104 F. 2d 837, 841 (4th Cir. 1939).