The Trust Receipt and the Problem of Recordation or Notice Filing

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THE TRUST RECEIPT AND THE PROBLEM OF RECORDATION OR NOTICE FILING

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The trust receipt as a security device originated in connection with purchases by importers from foreign manufacturers; however, it may be used as well in financing domestic transactions, and today it has become well entrenched in the domestic business world of the United States. The first extensive domestic use of this security device was by the automobile industry. From the automobile industry the trust receipt has now spread to many other articles sold to consumers on the installment plan, such as radios, refrigerators, washing machines, etc.

Since the date in 1876 when the first case to use the term “trust receipt” was decided, this security device has been a so-called “hot potato” for the judiciary. There has been great conflict and confusion as to what to do with the trust receipt—whether to recognize it as a security device sui generis, or whether to classify it as one of the existing well-entrenched security instruments. Probably the basic reason for this conflict has been the secret lien aspect of the trust receipt, and the court’s reluctance to give recognition to any device which would inflict a secret lien of any description upon the business world and the general public. This secret lien aspect of the trust receipt seemed to create an insurmountable obstacle in the field of security transactions. However, beginning with the UNIFORM TRUST RECEIPTS ACT of 1933 great progress has been made to clarify the status of the trust receipt and to overcome the conflict as to recordation or notice filing. Further progress may be expected as a result of the work being done on the proposed UNIFORM COMMERCIAL CODE.

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1. In re James, Inc., 30 F.2d 555 (2d. Cir. 1929); In re A. E. Fountain, Inc., 282 Fed 816 (2d Cir. 1922); In re Ford-Rennie Leather Co., 2 F.2d 750 (D. Del. 1924); Central Throwing Co. v. Muller, 197 Fed. 252 (3d Cir. 1912).

2. In re Boswell, 96 F.2d 239 (9th Cir. 1938); In re Bell Motor Co., 45 F.2d 19 (8th Cir. 1930).

I. The Nature and Characteristics of the Trust Receipt

In the case of Simons v. Northeastern Finance Corp.4 it is stated that:

'Trust Receipt' is a term applied to a written instrument whereby a banker having advanced money for purchase of imported merchandise and having taken title in his own name, delivers possession to the importer on agreement in writing to hold the merchandise in trust for the banker till he is paid.

Since an exact definition is difficult and frequently lacks clarity, I think an illustration will best describe this security device which is employed in short term financing of goods which the party financed takes for the purpose of resale, and not as an ultimate consumer.

The definition above refers to a case of purchases by an importer, but let us consider an illustration involving a domestic use of a trust receipt. An automobile dealer wishes to purchase five automobiles from the X Manufacturing Company. The terms of the manufacturer are cash on delivery. The dealer operates on a limited capital; therefore, he must rely on the new automobiles as security in order to obtain a loan to meet the purchase price. The situation is discussed with the dealer's banker, who arranges for a credit to an amount sufficient to cover the purchase price of the automobiles. The order is then placed with the manufacturer, with instructions to draw on the bank for payment and to forward the bills of lading in the name of the bank. The manufacturer forwards a draft with the bills of lading to the bank for acceptance. The bank then accepts the draft. Upon payment by the bank the manufacturer's interest in this transaction is ended and he is entirely removed from the picture. Then a trust receipt is drawn up whereby the bank turns over possession of the automobiles to the dealer, and whereby the dealer agrees to hold the automobiles in trust, to sell the automobiles and turn over the proceeds until the amount of the credit advanced by the bank, plus interest or commissions, is satisfied.

Generally, the trust receipt contains: the name of the bank (or financer); the name of the dealer; a description of the goods; a statement that the property is held in trust, title to

remain in the bank (or financer); specified limitation on the power of the dealer to use or sell the property; a direction as to the disposition of the proceeds upon sale of the property; a statement that the dealer is to pay all costs, attorney fees, taxes, insurance, etc., and that the risk of loss or injury is upon the dealer; a clause giving the bank (or financer) the right to retake possession of the property; a statement as to reports and accounts to be rendered to the bank (or financer) by the dealer and the right of the bank (or financer) to examine the books and goods. There may also be attached to the trust receipt a time draft or a bill of sale and promissory note.  

The parties in a trust receipt transaction are referred to as: (a) the trustee—the merchant (dealer or importer) who receives credit from the bank (or financer) and gives a trust receipt for the possession of the goods; (b) the entruster—the bank (or financer) which gives the trustee credit, receives title to the goods, and holds the trust receipt as security; and (c) the manufacturer (or vendor)—the party who receives the order for the goods from the merchant (trustee), receives payment from the bank (or financer), and turns over title, and thus the goods, to the bank (or financer).

The nomenclature of this security device and the parties thereto is somewhat confusing, since the terms imply a relationship to the equitable law of trusts. However, there is no connection whatever between the law of trust receipt and the equitable law of trusts, except by way of analogy in certain situations; nor does the relationship of entruster and trustee bear any direct similarity to the equitable relationship of trustee and cestui que trust. In a situation under the equitable law of trusts, the legal title vests in the trustee and the equitable title is in the cestui que trust. However, the reverse is true in a situation under a trust receipt—the legal title vests in the bank (or financer) for whom the property is held in "trust" by the dealer, and the beneficial ownership is in the dealer who gets possession by means of the trust receipt. The reader

5. See forms in: 1 MODERN LEGAL FORMS § 1115-1116, and Vol. 2, § 5270-5274; GORDON, MODERN ANNOTATED FORMS OF AGREEMENT 396 (1st ed. 1923).

should take precaution to distinguish between these two distinct fields of the law when thinking about the subject of this paper.

A. Rights and Liabilities of the Entruster and the Trustee

Since the trust receipt is a contract between the entruster and the trustee, it must conform to the laws governing contracts or it will not be binding even as to the parties thereto. As in any contractual agreement, the rights of the respective parties are controlled by the trust receipt itself.

At common law in those jurisdictions where the trust receipt is recognized as a security device sui generis, the rights and liabilities of the entruster and of the trustee are:

The rights and liabilities of the entruster

a. To be repaid by the trustee the amount of the advance made to the trustee plus specified interest or commission.

b. To retake the property from the trustee at any time before or after default.

c. To sell the property, in the event of retaking, and to apply the proceeds of the sale on the advance he made to the trustee.

d. To recover the balance, where the entruster retakes and sells the property for less than the amount of the advance plus the specified interest and commission.

e. To turn over to the trustee any balance which may remain over and above the amount of the advance plus interest and commission, in the event of retaking and selling of the property.

f. To have turned over to him by the trustee whatever proceeds from the sale of the property may come into the

hands of the trustee up to the amount of the advance plus interest and commission.

g. Whatever additional rights or liabilities are specified by the trust receipt.

The rights and liabilities of the trustee

a. To terminate the interest of the entruster under the trust receipt by repaying the advance plus interest and commission.

b. To have any profits resulting from the transaction, over and above the amount of the advance plus interest and commission.

c. To have any balance that may remain over and above the advance plus the specified interest and commission, in the event the entruster retakes and sells the property.\(^\text{12}\)

d. To assume any loss or injury to the property.\(^\text{13}\)

e. To have any benefits from increase in market value or accession.

f. To make up any deficiency in the event the entruster retakes the property and sells it for less than the amount of the advance plus interest and commission.\(^\text{14}\)

g. To deal with the property only as specified in the trust receipt.

h. To pay all costs, taxes, insurance, etc.

i. Whatever additional rights or liabilities are specified by the trust receipt.

B. The Interest of the Entruster and the Trustee in the Property

The courts have not agreed as to the exact nature of the title or interest in the property which is vested in the entruster or in the trustee; however, the title of the entruster seems to be generally recognized as a special form of security title,\(^\text{15}\) and the interest of the trustee that of a special form of beneficial ownership.\(^\text{16}\) In the case of *General Motors Acceptance Corp. v. Berry*\(^\text{17}\) it was held that the title of the entruster is not legal

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17. 86 N.H. 280, 167 Atl. 553 (1933).
title as that word is used in its full and legal significance. The entruster's title can be terminated by the trustee's repayment of the advance made by the entruster to the trustee. If the trustee sells the property, he is only accountable to the entruster for the amount of the advance; conversely, if the entruster repossesses and sells the property, he is accountable to the trustee for any balance remaining over and above that owed him by the trustee. The entruster does not share in the profits and risks of the trustee.

In the case of In re Richheimer the court stated that the entruster has title to the goods but only so far as is necessary to protect his loan; that the balance of the title, the residue which represents the excess of the goods or their value over the loan, is in the trustee. This analysis is logical and clear if we remember that the "legal" title to the property is actually in the entruster until the loan is satisfied, and the title to the proceeds, resulting from the sale of the property, over and above the amount of the advance arises only after the amount of the advance has been repaid. However, it appears that the reasoning of this court as to the title is likely to result in confusion and distorted opinions. One of the requisites of a pure trust receipt is that title is at no time in the trustee; it goes directly from the manufacturer to the entruster and remains there until the property is sold. In the case of In re Dunlap Carpet Co. the court said that the entruster takes title to the property as soon as the goods are bought by his payments, and he continues to hold that title as his indispensable security until the trustee sells the goods.

II. The Need for the Trust Receipt

As stated previously, the trust receipt originated in connection with purchases by importers from foreign manufacturers. The foreign manufacturer naturally demanded cash payments for the goods before he would export them; otherwise, his export business would be entirely too complicated and burdensome, especially when one of his purchasers defaulted on payment. Therefore, in order to import goods a sizeable amount of capital

18. 221 Fed. 16 (7th Cir. 1915).
was required. In fact, such a large amount of capital was required that unless the credit of banking capital was made available to the importers, this trade could be carried on only by those concerns having large capital and established foreign credit. Today, the same is true of many situations in our domestic business world. For example, the manufacturer of automobiles demands cash for his products. Therefore, unless the dealers throughout the country are provided with the credit and advances of banking and finance institutions, the automobile dealerships can only be carried on by those of considerable means.

What security is the importer, or dealer, of small capital able to give to the bank (or financer) for this advance? Generally, he does not have sufficient assets or credit upon which to rely for such advance; therefore, he must rely upon the goods themselves to furnish the security required by the bank (or financer).

The importer, or dealer, must control and sell the goods before he will be able to pay the advance made to him by the bank (or financer). Thus, we have a conflict between the necessity of the importer, or dealer, to control and sell the goods before payment, and the demand of the bank (or financer) to assert their claim upon the goods pending the payment of the advance.21

What security device will permit the title to the goods to pass directly from the manufacturer to the entruster and remain there until the goods are sold by the trustee, will reconcile the conflicting demands of the entruster and the trustee concerning the goods, will make repossession and sale by the entruster quick, easy, simple and inexpensive, and will facilitate this short-term financing transaction? A pledge is not the device, because possession in the bank (or financer) until payment of the advance is incompatible with the necessity of the importer, or dealer, to control and sell the goods before payment. A conditional sale is not the device, because the importer, or dealer, is not the ultimate consumer, nor is the bank (or financer) the vendor. A chattel mortgage is not the device, because the importer, or dealer, never has had title to the goods (title passes directly from the manufacturer to the bank or financer). From a practical business standpoint, a conditional sale or a chattel mortgage would not be desirable in this situation, because

either device would complicate the procedure and be burdensome if it became necessary for the bank (or financer) to collect the amount advanced by retaking possession of the goods, or foreclosing the mortgage. Nor is a consignment sale the device, because the entruster is not the original owner of the goods. Therefore, a new security device is required to provide all of the requisites of this transaction. That device is the trust receipt.

III. The Distinctions Between the Trust Receipt and Other Security Devices

A careful analysis of the trust receipt will reveal that it is a separate and independent security device, because the fundamental elements of a trust receipt are unique. In the pure trust receipt there are three distinct parties involved—the vendor (manufacturer), the entruster and the trustee. The entruster is never the vendor, or the original owner of the goods. The title passes directly from the vendor to the entruster and remains there until the goods are sold. Title is at no time in the trustee. This title is taken and retained by the entruster only to secure the payment for the goods which he made to the vendor on behalf of the trustee. The goods are transient and represent new merchandise to the trustee. The trustee is never the ultimate consumer but merely takes the goods for resale. Possession only is given to the trustee in order that he may resell the goods.

Regardless of the distinguishing characteristics of the trust receipt, there has been great conflict as to its true nature. For example, the trust receipt has been classified as a conditional sale, a chattel mortgage, a consignment for sale, a reserva-

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23. In re Collinwood Motor Sales, 72 F.2d 137 (6th Cir. 1934); In re Bettman-Johnson Co., 250 Fed. 657 (6th Cir. 1918); General Motors Acceptance Corp. v. Whiteley, 217 Iowa 993, 252 N.W. 772 (1934); Ahrens Refrigerator Co. v. R. H. Williams Co., 176 Okla. 5, 54 P.2d 200 (1936); Möhr v. First Nat'l Bank of Hanford, 69 Cal. App. 756, 232 Pac. 748 (1924); General Motors Acceptance Corp. v. Mayberry, 195 N.C. 508, 142 S.E. 767 (1928).
tion of title,26 a pledge,27 a bailment,28 and as a principal-agency relationship;29 however, many courts have held it to be a security device sui generis.30 In the case of In re Boswell31 it was stated that the trust receipt is associated with a security instrumentality that resembles a pledge, a chattel mortgage, or a conditional sale, that it is a transaction germane to these instrumentalities, but which is exactly none of these media of trade and credit.

A. The Pure Trust Receipt and the Bipartite Trust Receipt

In both the pure trust receipt and the so-called bipartite trust receipt, the same three parties are involved (the vendor, the entruster, and the trustee), and the purpose of the transaction is the same (to finance the trustee's purchase from the vendor). The only distinction lies in the course of the legal title. In the pure trust receipt the title passes directly from the vendor to the entruster, and remains there until the goods are sold. At no time is the title in the trustee. However, in the bipartite trust receipt the title is at some time in the trustee. For example, the vendor sends the bills of lading, and thus title, directly to the trustee, then the trustee endorses the bills of lading to the entruster, thereby passing title to the entruster. Here as between the entruster and the trustee, the title was originally in the trustee (thus the term "bipartite"); whereas

30. In re Boswell, 96 F.2d 239 (9th Cir. 1938); In re Bell Motor Co., 45 F.2d 19 (8th Cir. 1930); In re James, 30 F.2d 555 (2nd Cir. 1929); In re K. Marks and Co., 222 Fed. 52 (2nd Cir. 1915); Central Throwing Co. v. Muller, 197 Fed. 252 (3rd Cir. 1912); In re Catus, 183 Fed. 733 (2nd Cir. 1910); Houch v. General Motors Acceptance Corp., 44 F.2d 410 (W.D. Pa. 1930); Charavay and Bodvin v. York Silk Mfg. Co., 170 Fed. 819 (S.D.N.Y. 1909); In re E. Reboulin Fils and Co., Inc., 165 Fed. 245 (D.N.J. 1908).
in the pure trust receipt the title was originally in a third party, the vendor.

At common law, it was quite uniformly held that the bipartite trust receipt was not a security transaction sui generis, but was a chattel mortgage or a conditional sale, usually a chattel mortgage. In the case of Hartford Accident and Indemnity Company v. Callahan where title passed from the vendor to the dealer and then from the dealer to the financer, the court held that it was in reality a chattel mortgage, stating that the law recognizing the validity of the trust receipt should not be extended to permit one who claims to be the owner of the goods to borrow money on a document called a trust receipt by which he acknowledges that he holds his own property in trust for his creditor. The court in the case of In re A. E. Fountain, Inc., stated that the holder of a trust receipt has no better standing than the holder of an unfiled chattel mortgage, unless he derives his security title from a person other than the one responsible for the satisfaction of the obligation which the property secures.

B. The Trust Receipt and the Conditional Sale

The essential distinction between the trust receipt and the conditional sale is that the entruster is not, as is the conditional seller, the original owner of the goods; he is not the seller of the goods; and ordinarily the entruster has the right to repossess the goods at any time before sale (either before or after default), whereas the conditional seller may not repossess until after default by the purchaser. In the event the entruster retakes and sells the goods for an amount in excess of the advance he made on behalf of the trustee, this excess belongs to the trustee;


34. 282 Fed. 816 (2d Cir. 1922).
35. In re James, Inc., 30 F.2d 555 (2d Cir. 1929); In re Otto-Johnson Mercantile Co., 52 F.2d 678 (D.N.J. 1928).
whereas in a conditional sale the buyer is interested only in the amount he paid on account of the conditional sale contract. The consideration for a trust receipt contract is the advancement of funds by the entruster on behalf of the trustee, and not, as in a conditional sale, the delivery of goods to the buyer. The trust receipt may simply authorize the trustee to hold the goods for the entruster with no obligation on the trustee to sell them. In the event the trustee does not resell, the entruster retakes possession of the unsold goods. However, the conditional sale requires the buyer to pay for the goods.

C. The Trust Receipt and the Chattel Mortgage

It was stated in the case of In re Otto-Johnson Mercantile Company that:

The distinction (between the trust receipt and the chattel mortgage) is one that exists in fact—it is real and it is clear-cut and workable. This ground of differentiation is the fact that title does not pass to the bank from the importer, but rather from a third person.

Thus, since title has never been in the importer (trustee), he cannot convey it to the bank (entruster) in order to create a mortgage. If the entruster’s title does come from the trustee, the trust receipt is generally held to be a chattel mortgage.

Another distinguishing characteristic is that of the equity of redemption and reversion of the property. If the chattel mortgagor conveys his title to the mortgagee as security for the performance of an obligation of a third person, the equity of redemption belongs to the mortgagor, and not to the third person, and the property reverts to the mortgagor upon performance of the obligation by the third person. Whereas in a trust receipt transaction, the vendor (analogous to the chattel mortgagor) conveys his title to the entruster (analogous to the mortgagee) as security for the performance of the obligation of the trustee (the third person); any equity of redemption is in the trustee, and under no circumstances does title revert to the vendor.

36. In re James, Inc., 30 F.2d 555 (2d Cir. 1929).
37. 52 F.2d 678 (D.N.M. 1928).
38. Cases cited note 32 supra.
39. In re James, Inc., 30 F.2d 555 (2d Cir. 1929).
D. The Trust Receipt and the Pledge

The security of a pledge depends upon possession in the pledgee. The pledgor (debtor) transfers possession to the pledgee (creditor). Generally, the loss of possession by the pledgee results in the loss of the security. The title in a pledge situation is in the pledgor, or in a third person. In a trust receipt situation the reverse is true—the title to the property is in the entruster (analogous to the pledgee, creditor), and the possession is in the trustee (analogous to the pledgor, debtor). Ultimately the entruster had both title and possession to the property, thus the trustee had nothing to transfer to the entruster as security for his obligation.

IV. The Distinction Between the Trust Receipt and The Principal-Agent Relationship

The entruster and the trustee under a trust receipt deal with each other as distinct parties, and not as principal and agent. In the principal-agent relationship, the principal enjoys all of the benefits and suffers all of the risks connected with the goods. Whereas, in the entruster-trustee relationship, the trustee (analogous to the agent) bears all of the risks of loss and enjoys the benefits of any profits made in connection with the sale of the goods. If the trustee incurs liabilities to a third person, the trustee alone is responsible therefor; the third person cannot look to the entruster for payment, as he could look to a principal for satisfaction for liabilities incurred by an agent who acts within his authority.

The entruster is not engaged in the business of dealing in merchandise; he is a financer only. He does not participate in the selection of the goods, nor in fixing the purchase price to the ultimate consumer, nor in the transportation, processing, or selling of the goods. The entruster merely advances the purchase price at the instance of the trustee to the original vendor, on the condition that the title to the goods shall pass directly to the entruster and remain there as security until the amount of


the advance plus commission or interest is paid.\textsuperscript{42} Any further requirements imposed upon the trustee (such as a regular, periodic accounting, or a limitation upon the manner in which the trustee may deal with the property), are made solely for the purpose of protecting the entruster's interest in the transaction, and not for the purpose of engaging in the business of the trustee in any manner.

\textbf{V. The Recordation Requirements for the Trust Receipt Under Local Recording Laws}

As between the entruster and the trustee, the trust receipt is valid and enforceable even without recording.\textsuperscript{43} The confusion or conflict in the law as to the question of recordation arises when the interests of third parties intervene. These cases may arise in a number of different ways. The trustee may mortgage, pledge, or assign the goods in violation of the trust receipt, or he may become insolvent and the goods be seized by his trustee in bankruptcy. A third party may make a loan to the trustee relying upon the same goods as security, subsequent to the advance made by the entruster. A lien creditor may attempt to levy execution on the goods held by the trustee under the trust receipt.

Since the legal effect of the trust receipt is governed by the local laws of the jurisdiction where the transaction occurred,\textsuperscript{44} the rights of third parties are as varied as the judicial interpretation of the exact nature of the trust receipt.\textsuperscript{45} Where the trust receipt is recognized as a security device sui generis, the title of the entruster is held to be dominant to the claims of general creditors,\textsuperscript{46} and also dominant to the claim of a trustee in bankruptcy where the entruster repossesses the goods in anticipation of the insolvency of the trustee,\textsuperscript{47} even though the trust receipt is not recorded under the local recording statutes. But, even

\textsuperscript{42} In re Bettman-Johnson Co., 250 Fed. 657 (6th Cir. 1918).
\textsuperscript{43} Habegger v. Skalla, 140 Kan. 166, 34 P.2d 113 (1934); General Motors Acceptance Corp. v. Berry, 86 N.H. 280, 167 Atl. 553 (1933).
\textsuperscript{44} General Motors Acceptance Corp. v. Kline, 78 F.2d 618 (9th Cir. 1935); In re Collinwood Motor Sales, 72 F.2d 137 (6th Cir. 1934).
\textsuperscript{45} For further discussion of this point see: 12 N.Y.U.L.Q. Rev. 468 (1935).
\textsuperscript{46} In re Bell Motor Co., 45 F.2d 19 (8th Cir. 1930); In re James, Inc., 30 F.2d 555 (2d Cir. 1929).
\textsuperscript{47} Houch v. General Motors Acceptance Corp. 44 F.2d 410 (W.D. Pa. 1930).
where the trust receipt is recognized as sui generis, the bona
fide purchaser in the ordinary course of business is protected
on the basis that the trustee had authority to sell and the entrus-
ter is estopped to assert his title as against the bona fide pur-
chaser. However, where the trust receipt is classified as one of
the other security devices, such as a chattel mortgage or a con-
ditional sale, the rights of the third person are governed by
the law of the particular device.

Before 1930 a majority of the cases held that the trust re-
ceipt was a security device sui generis, or at least not a con-
ditional sale nor a chattel mortgage, and, therefore, was valid
without recording. However, since 1930 there has been a de-
cided trend toward the prevention of secret liens, and to require
the trust receipt to be recorded on the ground that this is the
type of transaction which was intended to fall within the
recording act. This trend since 1930 has certainly brought
about great conflict and confusion in the law. As an example,
let us look at the various grounds upon which the courts have
held that the trust receipt comes within the recording acts.

In the case of General Motors Acceptance Corp. v. Seattle
Association of Credit Men it was not decided whether the trust
receipt was a chattel mortgage or a conditional sale, but the
court stated that secret liens whereby rights are acquired or
attempted to be acquired or retained at the expense of general
creditors are not favored in the law, and held that the trust
receipt was not sui generis, therefore it must be recorded to be
valid as to third parties. In C.I.T. Corp. v. Seaney it was not
decided just what kind of a security device the trust receipt
was, but it was held that the transaction resulted in the real
interest of the finance company being that of a lienholder and
thus subject to the provisions of the recording statutes. In
Motors Banker's Corp. v. C.I.T. Corp. it was held that the
trust receipt was "in the nature of a chattel mortgage" and

48. Foreign Trading Banking Corp. v. Gerseta Corp., 237 N.Y. 265, 142
N.E. 607 (1923); Glass v. Continental Corp., 81 Fla. 687, 88 So. 876 (1921).
49. 9 U.L.A. 666 (1942); Smith v. Com'l Credit Corp., 113 N.J. Eq. 12,
165 Atl. 637 (1933).
51. 53 Ariz. 72, 85 P.2d 713 (1939).
52. 258 Mich. 301, 241 N.W. 911 (1932).
thus must be recorded. In the case of *Central Acceptance Corporation v. Lynch*\(^53\) it was stated:

In the present case we are dealing with the validity of commercial trust receipts under the Ohio recording statutes . . . . Under these statutes it is now the settled law of Ohio that if the title conveyed to the holder of the trust receipt is only for security for the payment of a debt, the trust receipt must be characterized either as a chattel mortgage, as in *Thorne v. First National Bank*, 37 Ohio St. 254, or as a conditional sale as *In re Bettman-Johnson Co.*, 23 F. (2d) 10 (C.C.A.6). . . . In either event the receipt must be filed with the county recorder in order to prevail against the trustee in bankruptcy.

It was held in *General Motors Acceptance Corp. v. Sharp Motor Sales Company*\(^54\) that the Kentucky rule is that whatever may be the name or form of a transaction, when it is designed to hold personal property as a mere security for a debt, it is regarded as a chattel mortgage, and thus must be recorded. In the case of *In re Draughn and Steele Motor Company*\(^55\) the court stated that the Kentucky recording act applied only to mortgages, but that a conditional sale was construed to be a mortgage upon the ground that it is an attempt to evade the recording statute; that to change a conditional sale into a mortgage calls for no greater wrench than to change a trust receipt into a mortgage.

It is evident that the controversy over the problem of recordation of the trust receipt is not new; it is a part of the age-long conflict between the commercial interests among borrowers and financiers in achieving convenient, inexpensive, workable security devices which will adequately protect their interests and the interests among the potential creditors and bona fide purchasers in avoiding secret title reservations or secret liens.\(^56\)

**VI. The Need for a Uniform Act**

As pointed out in previous sections, there is not only conflict between jurisdictions as to the nature and legal effect of a trust

\(^{53}\) 58 F.2d 915 (6th Cir. 1932).
\(^{54}\) 233 Ky. 290, 25 S.W.2d 405 (1930); accord, *Smith v. Com'l Credit Corp.*, 113 N.J. Eq. 12, 165 Atl. 637 (1933).
\(^{56}\) Pemberton, Jr., *Notice Filing for Assignments of Accounts*, 13 LAW AND CONTEMP. PROB. 643 (1948).
THE TRUST RECEIPT

receipt, but there is also conflict within certain jurisdictions. It is difficult to ascertain the rights of the parties to a trust receipt transaction, as well as the rights of third parties. Under the common law, even with the exercise of precaution, rights are frequently indefinite. For example, in the case of General Contract Purchase Corp. v. Bickert the trust receipt was recorded as a conditional sale, but the court held that it was a chattel mortgage; thus the entruster lost his rights as against the third party. It was also pointed out previously that much of our trade could hardly be carried on by any means other than the use of the trust receipt; therefore, the financer's advance of money and credit, which is the fundamental factor in the transaction, deserves the ampest protection.

The validity of a trust receipt as a security instrument sui generis should not turn upon the formality of the source of the entruster's title, because the fundamental purpose of and need for the transaction is the same whether the vendor transmits the bills of lading directly to the entruster or whether he transmits the bills of lading to the trustee who then endorses them over to the entruster. Yet it is well established by case law that the trust receipt cannot be extended to include the bipartite transaction.

The solution of the problem of the trust receipt lies in a functional approach based upon sound economic policy and practice. There must be a balancing of the interests of the trustee who has a dire need for trust receipt financing, of the entruster who is reluctant to bear the burden and expense of recording each transaction, of the occasional creditor who searches the records, and of other third parties who may have claims against the trustee. Since the courts can only choose between the two extremes of recording or not recording, they cannot give a satisfactory solution to the problem. A uniform act is the only possible solution.

VII. The Uniform Trust Receipt Act
The Uniform Trust Receipts Act was first adopted by the National Conference of Commissioners on Uniform State Laws in 1933. The first state to adopt the Act was New York, May 12,

57. 10 N.J. Misc. 958, 161 Atl. 830 (1932).
1934. Since that date the Act has been adopted by twenty-seven other states.\textsuperscript{58}

This Uniform Act is somewhat unique in that less emphasis was placed upon the case law and more emphasis upon the established business policy and practice. The purpose of the Act was to retain the advantages of a security interest in goods by the use of a trust receipt and yet to eliminate, as far as possible, both secret liens and the necessity of recording each transaction.\textsuperscript{59} It gives full protection to bona fide purchasers in the ordinary course of trade and also to pledgees or mortgagees for new value with possession, but gives the entruster preference over general creditors of the trustee if the entruster complies with the Act. Instead of requiring a filing or recording of each transaction locally, the Act provides for central notice filing of the intention to engage in a trust receipt transaction, thus it affords a convenient and inexpensive method of filing and also eliminates the necessity for a potential creditor to search a great mass of filed or recorded papers.

The preface to the Act, which contains a statement of the committee acting for the National Conference of Commissioners on Uniform State Laws, gives an excellent survey and explanation of the provisions of the Act.\textsuperscript{60}

\textbf{VIII. The Proposed Uniform Commercial Code}

The proposed Uniform Commercial Code (hereafter referred to as the Code) was begun in January 1945, as a joint project of the American Law Institute and the National Conference of Commissioners on Uniform State Laws. The first draft was completed in December 1949. During the intervening period, drafts have been considered by joint committees of the sponsoring organizations and have been debated by the full membership of each organization at annual meetings.

It had been planned to submit the Code for final approval at the joint session of the sponsoring organizations held at Wash-


\textsuperscript{59} Donn v. Auto Dealers Investment Co., 385 Ill. 211, 52 N.E.2d 695 (1944).

\textsuperscript{60} See appendix \textit{infra}. 

Washington University Open Scholarship
ington, D. C., in May 1950; however, a resolution was adopted instead postponing final approval until the joint session in May 1951. This resolution stated that many suggestions and criticisms are still being received by the editorial board from various business association committees and affected business groups, and that many interested groups had requested additional time for study of the Code.

The Code is a very comprehensive act covering the field of commercial transactions in or regarding personal property, including sales, commercial paper, foreign remittances, letters of credit, banks deposits and collections, certain other banking transactions, investment securities, documents of title, and various types of financing security. Only those portions of the Code which have some bearing upon the problem of the trust receipt will be discussed in this paper. All references will be to the proposed final draft, Spring 1950.

A. The Scope of Article 9 (Secured Transactions) of the Code

Article 9, entitled Secured Transactions, of the Code is a comprehensive regulation of security interests in personal property. Sec. 9-101 comment. It applies regardless of the form of the transaction out of which the security interest arises, and includes a pledge, chattel mortgage, chattel trust, conditional sale, equipment trust, bailment lease, trust receipt, other lien or title retention contracts and any other transaction intended to have effect as security. Sec. 9-102 (2).

The Code supersedes not only the Uniform Trust Receipt Act and the Uniform Conditional Sales Act, but also existing state legislation dealing with chattel mortgages, factors liens, assignments of accounts receivable, inventories, and any other inconsistent statutes. Sec. 11-102 and comment. Since it is planned to present the Code for adoption by the United States Congress, it also provides a repealer section for all inconsistent Federal Acts. Sec. 11-104. Existing security devices are not specifically abolished by the Code, but if they are used the Code rules will govern. Sec. 9-102 comment.

B. General Purpose and Theory of Article 9 of the Code

Article 9 of the Code is truly a functional approach to security law. The rules are based primarily upon the fundamental purpose of the security transaction and upon the type of collateral
used as security. The complicated rules regarding the form of a security transaction are abolished. The chief objective is to provide full freedom of contract between the lender and the borrower, with that freedom being restricted by the unsecured creditor only to the extent of a method by which he may be informed of the arrangement. The comment to section 9-101 states that the aim of the article is to provide a simple and unified structure within which the great variety of existing secured financing transactions can go forward, with less cost and greater certainty.

The traditional distinctions between security devices which are based largely upon form, are abolished; the article applies to all transactions intended to create a security interest in personal property. The single term "security interest" is substituted for the numerous security devices which grew up at common law and under separate statutes. Sec. 9-101 comment. However, all security transactions are not treated alike. Distinctions, based upon functional differences, are made between various types of personal property used as collateral, such as industrial and commercial, business inventory, farm products, consumer goods, documents of title, and where appropriate special rules are made applicable to transactions involving each type of collateral. Sec. 9-101 comment.

Article 9 is very flexible and contains simplified formalities, thereby making it possible for new forms of security transactions as they develop to fit under the Code provisions. This avoids the necessity of passing new legislation or distorting old statutes or security devices in order to allow new, legitimate business transactions to go forward. Sec. 9-101 comment.

C. Article 9 of the Code and The Uniform Trust Receipts Act

Article 9 of the Code relies very heavily upon the Uniform Trust Receipts Act (hereafter referred to as the U.T.R.A.). The comments to this section of the Code indicate that many of the sections adopt the approach and follow the rules of the U.T.R.A. With a few exceptions, the general theory of article 9 of the Code and the U.T.R.A. are the same. However, the U.T.R.A. did not change the existing laws of chattel mortgages and conditional sales, whereas the Code repeals those laws and em-
braces all security devices under Article 9. Under the Code a lender who has complied with Article 9, need no longer fear the loss of his security interest because he has called his security instrument by one name instead of another, nor does he have to worry about filing under the proper statute or electing between filing statutes as provided for under U.T.R.A. Section 16.

Article 9 of the Code not only includes the bipartite, as well as the tripartite, trust receipt, but goes further than the U.T.R.A. and provides that the article applies with regard to rights, obligations and remedies of the lender, the debtor or third parties, whether the title to the collateral is in the lender or the debtor. Code Sec. 9-202. The Code in Section 9-107 (c) also provides that if for the purpose of enabling the buyer (dealer or trustee) to acquire the goods, the financer makes advances to the buyer ten days before or after receipt of the goods, the lender has a purchase money security in the goods, whether or not such money was in fact used to pay for the goods. The reason for this conclusive presumption is the difficulty of tracing.

Code Sec. 9-307 (1) follows U.T.R.A. Sec. 9 (2) (a) in protecting a buyer in the ordinary course of trade, even though the security interest of the lender is perfected or filed; however, the Code section makes it clear that the rule applies even though the buyer has actual knowledge of the security interest. This Code section also stresses the point that not only must the buyer be in the ordinary course of trade, but also the dealer (debtor or trustee) must be engaged in selling goods of the description involved.

The U.T.R.A. Sec. 11 and the Code Sec. 9-310 are similar in that both provide for priority of specific liens arising by virtue of a person in the ordinary course of his business furnishing services or materials with respect to goods subject to a security interest, such as services by warehousemen, carriers and processors.

In the case of insolvency of the trustee, the U.T.R.A. Sec. 10 (b) entitles the entruster to any proceeds or the value of any proceeds (whether such proceeds are identifiable or not) resulting from disposition of the goods by the trustee, if such proceeds were received by the trustee within ten days prior to either application for appointment of a receiver, or the filing

http://openscholarship.wustl.edu/law_lawreview/vol1951/iss1/6
of a petition in bankruptcy or judicial insolvency proceedings, or demand made by the entruster for prompt accounting, and to a priority to the amount of such proceeds or value. The Code Sec. 9-306 (2) follows this U.T.R.A. section but it restricts the entruster's right to the cash and checking accounts of the trustee equal to the amount of the cash proceeds received by the trustee within ten days prior to the institution of insolvency proceedings. This is the entruster's only right to cash proceeds in case of insolvency of the trustee; he is not entitled to any option or priority in any other respect.


Those engaged in trust receipt financing strongly opposed recordation or notice filing. The entrusters' opposition was based upon the proposition that the trust receipt is an instrument well known in the field of importation and the domestic automobile industry, and thus persons dealing with importers or automobile dealers would naturally inquire as to whether the importer or dealer was engaged in this form of financing transaction; that the cost and burden of recording or filing would prohibit many of these transactions; and that since the trust receipt was generally limited to short-term financing the accumulation of obsolete recorded trust receipts would be tremendous. The trustees opposed recordation or notice filing because they did not want the general public to know that their goods were secured under a financing arrangement for fear that it might be accepted as evidence of dire financial distress and affect the potential customer's attitude toward their business. Potential creditors argued that the trust receipt financing was not restricted entirely to importers and domestic automobile dealers; that they were entitled to be apprised of all security interests even though they were restricted to a short term; and that an inexpensive, convenient system of filing could be devised which would put them on notice that a security interest existed and yet not reveal information which might prove detrimental to the trustee's business.

The place of filing also caused considerable controversy. Many advocated a system of filing by counties or comparable local units analogous to the recording required for chattel mort-
gages and conditional sales; however, those who proposed the central notice filing system presented a much more reasonable, workable plan. The central filing system is more adaptable to this type of financing transaction and reaches a more reasonable result in balancing the interests of all parties who may be concerned. In devising a workable system, the purpose and function of filing must be the predominant consideration. The primary purpose of filing is to give information to those who deal with the borrower (trustee); therefore, the filing must be in a place which is readily accessible to all those who might be concerned. The system must be inexpensive, convenient, and eliminate the burdensome job of extensive searching. It must assure the financer that he has protected his interest; therefore, the filing must be in a central place, so that the financer is not subjected to the peril of determining what law governs the transaction, where to file his instrument, or where to search for prior claims. It is equally important to assure others who deal with the trustee that they may search in one central place and find any prior claims against the trustee regardless of where the claims are located within the state.

As a result of the U.T.R.A. and the work being done on the Code, an excellent system of central notice filing has been devised which very equitably balances the various arguments concerning recordation or notice filing, the conflicting views as to the place of filing, and the interests of all parties who are, or may become, concerned in the financial or security transactions of the borrower (trustee).

The notice filing required under the U.T.R.A. and Article 9 of the Code should not be confused with the "recordation" required by the various recording acts, although the two terms are frequently used interchangeably. The notice filing, unlike recordation, does not require a recording of each transaction, but only the filing of a single, simple notice that the entruster and trustee are engaging, or intend to engage, in a trust receipt transaction. Section 9-403 of the Code follows the U.T.R.A. Section 13 (1) in requiring that the notice filed is a statement, signed by the entruster and the trustee, containing the address of the place of business of the two parties, a statement that the entruster is engaged, or intends to be engaged, in financing under trust receipt transactions the acquisition of goods by
the trustee, and a description of the kind or kinds of goods covered or to be covered by such financing. This simple notice requirement is based upon the theory that all that a creditor needs to know in the first instance is that goods of a general description are subjected to a security interest; if the creditor wants more information this simple notice indicates where and from whom he may obtain such additional information. This statement is filed with the secretary of state, whereas under the recording acts the recordation must be within the county where the transaction occurred or where the property is located.

Centralized state filing, in lieu of the chattel mortgage and conditional sales types of filing by counties, was adopted by U.T.R.A. Sec. 13. The Code Sec. 9-401 follows this system of filing, but also provides that in addition to the filing with the secretary of state, filing is required in the county if all of the debtor's places of business are in a single county. This portion pertaining to additional filing in the county is within brackets in the Code, indicating that each legislature is to determine whether or not they wish to adopt this additional filing requirement. The Code in Section 9-402 goes further than the U.T.R.A. and covers the situation where the collateral is subject to state or federal regulation. This section provides that a security interest in goods subject to a federal statute requiring registration of or filing of the security interest or to a statute of the state requiring registration of all liens on certificates of title, in order to perfect the security interest against third parties, is perfected under Article 9 of the Code from the time of registration or filing under such statute, and the provisions of Article 9 of the Code with regard to filing do not apply. For example, a federal statute requires a security interest in airplanes to be filed with the Civil Aeronautics Administration in Washington, D. C. (49 U.S.C. Sec. 523), and many motor vehicle statutes provide for central filing or registration of liens on automobiles in order to perfect the security interest.

U.T.R.A. Section 8 (1) provides that the entruster's security interest in the goods shall without any filing be valid as against all creditors of the trustee, with or without notice, for thirty days after delivery of the goods. Article 9 of the Code does not follow this U.T.R.A. rule of thirty day validity without
filing. The Code Section 9-301 (2) provides that if a secured lender (entruster) files before or within ten days after he gave value, his interest takes precedence over the interest of a transferee in bulk or of a lien creditor whose interest arises between the time the security interest attaches and the time time of filing. Except in Section 9-301 (2) the Code contains no concept of relation back or grace period so as to permit a lender or entruster to file after another interest has intervened and thereby defeat the intervening interest. Thus another secured lender, or a purchaser receiving delivery, who files within the ten day period is entitled to protection of his interest.

Section 13 (4) of the U.T.R.A. makes the filing of a statement valid for a period of one year from the date of filing and any advances made to the trustee within that year are protected under this filing. U.T.R.A. Section 13 (5) provides for refiling before the expiration of the validity of the filing. This refiling is also valid for one year from date of refiling. The Code Sections 9-404 and 9-405 contain improvements over the U.T.R.A. After discharge of the obligation secured or at any time if no advance has been made under the financing statement previously filed, the entruster must upon a written demand from the trustee execute and deliver a statement that the financing arrangement has been terminated or that no lien or right exists. Code Sec. 9-405. This prevents the possibility of the entruster enjoying a monopoly in financing the trustee or of hamstringing the trustee so that the trustee cannot obtain funds either from the entruster or a third person. The Code Section 9-404 (2) states that a financing statement is effective until a statement of termination is delivered, as above, unless the statement lapses as provided in Section 9-404 (3). As a substitute for the U.T.R.A. provision of one year validity and refiling to extend the effectiveness for one year, the Code Section 9-404 (3) permits a filing officer at the end of five years from the date of filing to notify the entruster that the effectiveness of the filing will lapse sixty days following the date of notification. If the entruster does not file a new statement before the expiration of this sixty day period, the effectiveness lapses. If he does refile the statement will be effective until a statement of termination or until this statement lapses as provided in Section 9-404 (3).
2. The Problem of Priority Between the First to File and the First to Advance Funds

There have been relatively few decisions under the U.T.R.A., but probably the most controversial case yet decided was Donn v. Auto Dealers Investment Co. 61 In that case all the trust receipt transactions upon which both the plaintiff and the defendant advanced money to the automobile dealer on the same cars occurred after both the plaintiff and the defendant had filed statements with the secretary of state. The plaintiff filed on May 25, 1939, and the defendant on August 16, 1939. The defendant was the first to advance funds to the dealer under trust receipts. There was no evidence that either the plaintiff or the defendant knew that the other was advancing money to the dealer on the same automobiles. The dealer defaulted on payment and the defendant took possession of the cars, sold them at public sale and applied the proceeds to the debt of the dealer. Plaintiff sued claiming priority of his trust receipt. The court held for the defendant, stating that:

These provisions of the Act indicate that the thing which vests in the entruster a security interest in the goods acquired by the trustee is the trust receipt transaction and not the filing of the statement with the Secretary of State. The filing of such statement serves to put all contemplated creditors on notice and defendant, when he filed his statement, had constructive notice of plaintiff's filing and was put on inquiry to learn from the trustee whether plaintiff held security interest in the goods sought to be pledged to him. Plaintiff by the same token, had constructive notice of the defendant's statement when and after it was filed and thereafter was likewise put on inquiry to learn from the trustee whether the defendant had advanced funds and received trust receipts on the specified goods offered to him, the plaintiff, for a trust receipt transaction.

There is a danger under the U.T.R.A. that the entruster who files first might enjoy a monopoly on the business of the trustee, if the first to file priority prevails. Another financer probably would not enter into a trust receipt transaction with the trustee if he finds on file with the secretary of state a statement of another entruster. Also, under the U.T.R.A., an entruster may alone file another statement with the secretary of state be-

61. 385 Ill. 215, 52 N.E.2d 695 (1944).
fore the end of the first year, and thus continue the relationship without the consent of the trustee.

The Code in Section 9-312 (1) provides that an interest attaching after a financing statement has been filed takes priority from the time of its filing, and unless otherwise agreed to by the earlier lender such priority holds also as to later advances made by him under the statement. While providing for first to file priority, the Code eliminates the possibility of a monopoly by an entruster on the business of the trustee. Section 9-405 of the Code provides a procedure whereby the trustee may terminate the validity of the filed statement if the obligation secured has been discharged or if no advance has been made under the financing statement.

The Code appears to reach an equitable result. It would seem to be an undue burden to place upon the first filing financer to require that before he makes an advance to the trustee he must go back to the secretary of state to see whether someone else has gone in after him. In the Donn v. Auto Dealers Investment Company case if the defendant (the second to file, but first to advance funds) had inquired of the secretary of state he would have discovered that the plaintiff had previously filed a statement of intention to engage in trust receipt transactions with the trustee. Then he could have ascertained whether the plaintiff had advanced funds under the filed statement. Upon discovering that no funds had been advanced by the plaintiff, he could have refused to advance funds to the trustee until the trustee, under the provisions of Code Section 9-405, required the plaintiff to execute and deliver a statement that the financing arrangement between the plaintiff and the trustee had been terminated. At this point the defendant could have filed his statement and advanced funds to the trustee upon the assurance of his security interest being entitled to priority. This would prevent fraudulent double financing peculiar to the notice filing system.

IX. Summary

The trust receipt as a security device was originally used in the field of importations; however, due to its peculiar adaptability to the short term financing of dealers in such items as automobiles, radios, refrigerators, and washing machines, the de-
vice has become well entrenched in our every day business transactions. Since the time when the term "trust receipt" was first used in a case of this country, there has been great conflict as to the true nature of this security instrument and the effect of the recordation laws upon it. A thorough understanding of the characteristics and purposes of the trust receipt will reveal that it is not a conditional sale, a chattel mortgage, or some other device, and that it should be regarded as a security device sui generis.

Where the manufacturer demands cash for his goods, the dealer must either have a large capital in order to obtain his inventory, or he must have the advantages of credit and advances of banking and finance institutions. Since only a relatively few dealers have the capital required, it is essential that credit and advances be made available to dealers. Generally the dealer who requires this credit and advance, must rely upon the goods themselves to furnish the security required by the financer. The dealer must control and sell the goods before he will be able to pay the advance made to him by the financer; at the same time the financer demands an assertion of his claim upon the goods pending the payment of the advance. The trust receipt is the only security device which will permit the title to the goods to pass directly from the manufacturer to the entruster (financer) and remain there until the goods are sold by the trustee (dealer), and will reconcile the conflicting demands of the entruster and the trustee concerning the goods. Thus there is a dire need for the trust receipt to be recognized as a security device sui generis.

Prior to 1930 a majority of the cases held that the trust receipt was neither a chattel mortgage nor a conditional sale, and was valid without recording. It was distinguished from a chattel mortgage principally by the fact that the financer derived his security title from a third party (the manufacturer or vendor), and not from the borrower (trustee) as in a chattel mortgage; and from a conditional sale principally by the fact that the financer, holding a security title, was not the vendor of the goods as in the case of a conditional sale. Since 1930, however, there has been a decided trend toward the prevention of secret liens, and to require the trust receipt to be recorded
THE TRUST RECEIPT

57

on the ground that this is the type of transaction which was intended to fall within the recording acts.

The problem of whether or not a trust receipt should be recorded should not turn upon merely formal distinctions. The solution of the problem lies in a functional approach based upon sound economic policy and practice. There must be a balancing of the interests of the trustee who has a dire need for this financing transaction, of the entruster who is reluctant to bear the expense and burden of recording each transaction in short term financing, the occasional creditor who searches the record, and of other parties who may have claims against the trustee. The courts cannot give a satisfactory solution to the problem, because they can only choose between the two extremes of recording or not recording; therefore a uniform act is essential.

The Uniform Trust Receipt Act adopted in 1933, and since that date adopted by twenty-eight states, is a great step toward a solution of this vital problem. The primary objective of the Act is to reconcile the present conflict in the decisions relating to the trust receipt, to protect the interests of third parties who need protection from secret liens, and at the same time to preserve the essential advantages of this security instrument. This Act is somewhat unique in that less emphasis was placed upon the case law and more emphasis upon the established business policy and practice.

The proposed Uniform Commercial Code, which is being prepared by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, will probably contain a very workable solution to the problem of the trust receipt. The Code is a comprehensive act covering the field of commercial transactions in or regarding personal property. Article 9 of the Code, entitled Secured Transactions, is a comprehensive regulation of security interests in personal property and represents a truly functional approach to security law. This article applies regardless of the form of the transaction out of which the security interest arises, and includes all transactions intended to have effect as security. The rules are based primarily upon the fundamental purpose of the security transaction and upon the type of collateral used as security, and the complicated rules regarding the form of a security transaction are abolished.
Article 9 of the Code relies to a great extent upon the Uniform Trust Receipts Act. With a few exceptions, the general theory of the two are the same, and many of the sections of Article 9 of the Code adopt the approach and follow the rules of the Uniform Trust Receipts Act. However, Article 9 of the Code represents many improvements over the Uniform Trust Receipts Act, as well as over the most of our existing security law. It is very flexible and contains simplified formalities, thereby making it possible for new forms of security transactions as they develop to fit under the Code provisions. This avoids the necessity of passing new legislation or distorting old statutes or security devices in order to allow new, legitimate business transactions to go forward, as has been necessary in the case of the trust receipt during the course of the past seventy-four years.

The trust receipt illustrates one of the numerous problems confronting the courts and the business world because of the inadequacy of our existing law of commercial transactions. It also illustrates the need for every member of the legal profession to take an active interest in the work being done on the proposed Uniform Commercial Code, and to offer any constructive criticism to the sponsoring organizations.

APPENDIX

The following excerpts were taken directly from the preface to the Uniform Trust Receipts Act.

A. Scope of the Act

"The Act regulates not only the 'orthodox' importing trust receipt transaction, but the analogous domestic transaction. Sec. 2. It also regulates—and validates—the use of a trust receipt in favor of a pledgee where the pledgor-dealer happens to have already acquired title. This materially simplifies business procedure by doing away with troublesome and artificial distinctions. Sec. 2(1) (b); Sec. 2(1) lines 27-29; also Sec. 3.

"The Act leaves the existing law of chattel mortgages and conditional sales unchanged, except in peculiar cases which need special coverage. (a) Sec. 1 'Entruster,' excludes any true seller from the operation of the Act, and limits the definition of 'Security interest,' in that Section. Thus any true conditional sale is outside this Act. (b) Sec. 2(3), by limiting the purposes of a trust receipt transaction, excludes the ordinary chattel mortgage even when made by a dealer. (c) Sec. 2(1) and Sec. 1, 'new value,' limit the effectiveness of the transaction to the case of new acquisitions by the dealer, as to which the new possession cannot be expected to mislead his creditors, or to the turning back to him of security already pledged, which
Sec. 14 limits the financer's protection to new value given as a part of the transaction. (d) Finally, Sec. 3 makes it clear that the purposes of the Act cannot be defeated by masking what in substance would be an unrecorded chattel mortgage under the forms of agreement to pledge or 'equitable pledge.'

B. General Theory of the Act

"The Act accepts the desirability of protecting the new financing of a dealer's incoming stock ... while allowing possession to be in the dealer ... for legitimate purposes looking toward realization or substitution of the security. This accords both with business practice and business needs.

"The Act proceeds on the theory that the entruster in such case is entitled to protection only against honest insolvency of the trustee. Dishonest action of the trustee is a credit risk, and bona fide purchasers are to be protected against the entruster who has taken that risk by entrusting. (But for the bona fide purchaser to be protected, he must be such a purchaser in 'the ordinary course of business.' Sec. 9 (2) (b).

"The Act provides for a reasonable period of validity of the entruster's security interest without filing (30 days for a trust receipt transaction. Sec. 8 (1); 10 days for an imperfect pledge for new value. Sec. 3 (1) (a)). The 30 day period is ample to cover any truly temporary purpose. The 10 days period fixes definitely the rights of the purported pledgee in cases of agreements to pledge not yet perfected by taking possession; a needed reform—for under the present law the rights of such a 'pledgee' are wholly indefinite. Perhaps even more important, the provision of the Act effectively bars later fraudulent pretense that such an agreement 'had been made long before,' which is one frequent way of depleting insolvent estates.

"The Act provides for a type of filing which is convenient, cheap, and effective. The filing reveals all that a prospective creditor of the dealer needs to know, but reveals nothing more than that. Sec. 13.62

"The Act provides for centrally accessible filing in a single office for the entire state. This is vital to the policy of simplifying the filing provisions and to making the information readily and certainly available without expensive search. See. 13 (1).

C. What the Act Does for the Financer or Entruster

"It frees him from the elaborate procedure necessary under the common law to keep title from ever getting into the trustee. Sec. 2 (1).

62. Sec. 13(1) provides that: Any entrusted undertaking or contemplating trust receipt transactions with reference to documents of goods is entitled to file with the (Secretary of State) a statement, signed by the entruster and the trustee, containing:

(a) A designation of the entruster and the trustee, and of the chief place of business of each within this state, if any; and if the entruster has no place of business within the state, a designation of his chief place of business outside the state; and

(b) a statement that the entruster is engaged, or expects to be engaged, in financing under trust receipt transactions the acquisition of goods by the trustee; and

(c) a description of the kind or kinds of goods covered or to be covered by such financing.
“Where the financing extends beyond the temporary period (30 days), it gives him convenient and workable provisions for filing and refiling. Sec. 13.63

“It frees him from doubt and risk, where two divergent filing provisions cover the same transaction, and allows him his due protection by compliance with either. Sec. 16.

D. What the Act Does for the Dealer, Borrower, or Trustee

“Whenever the trust receipt has been held invalid at common law, the Act provides for a filing which is clearly restricted to new financing, and so protects the dealer’s credit from the evil effects of having a chattel mortgage appear on the record against him.

“The filing required reveals nothing to the dealer’s competitors of the price paid by him for the merchandise covered by the financing. See form, Sec. 13 (2).

E. What the Act Does for Purchaser (including Pledgees, Mortgagees and Transferees in Bulk) from the Dealer or Trustee

“In the case of imperfect pledge, it preserves the bona fide purchaser’s common law protection. Sec. 3 (2).

“It enables warehousemen, carriers, and processors to rely on the trustee’s possession (and profession), so far as concerns specific liens for their services. Sec. 11.

“It frees the buyer in ordinary course of trade from any constructive notice by virtue of filing. Sec. 9 (2) (a) (i).

“The Act protects a buyer in a purchase in due course on credit against the antiquated equity doctrine that a price as yet unpaid is not ‘value.’ This permits normal business to go on, merely substituting the entruster (after due notice) as the purchaser’s creditor. Sec. 9 (3).

“But a purchaser not in ordinary course of trade is affected by filing. Sec. 9 (2) (b). That subsection comes to this:

(i) A bona fide pledgee or mortgagee for new value takes free of the entruster’s interest, even within the temporary period, if he also obtains possession. (cf. Sales Act, Sec. 25.)

(ii) Not so a pledgee or mortgagee for old value, or a transferee in bulk.

63. Sec. 13(1) supra note 60; Sec. 13(5) provides: At any time before expiration of the validity of the filing . . . a like statement, or an affidavit by the entruster alone, setting out the information required by subsection 1, may be filed in like manner as the original filing. Any filing of such further statement or affidavit shall be valid in like manner and for like period as an original filing, and shall also continue the rank of the entruster’s existing security interest as against all junior interests.

64. Sec. 1, “Buyer in the ordinary course of trade” means a person to whom goods are sold and delivered for new value and who acts in good faith and without actual knowledge of any limitation on the trustee’s liberty of sale, including one who takes by conditional sale or under a pre-existing mercantile contract with the trustee to buy the goods delivered, or like goods, for cash or on credit. “Buyer in the ordinary course of trade” does not include a pledgee, a mortgagee, a lienor, or a transferee in bulk.
(iii) After the temporary period, and before filing, any pledgee, mortgagee or transferee in bulk, even for old value, takes free of the entruster's interest if he obtains delivery.

(iv) After filing, no pledgee, mortgagee or transferee in bulk can take free of the entruster's interest. The reason is clear: All of these are persons whose business it is to look up the status of any trustee with whom they are dealing.

"Even when a purchaser has notice, the entruster's rights are limited to the new value given by him in connection with the transaction, or to the interest he previously held. Sec. 14.

F. What the Act Does for Creditors

(Lien Creditors and General Creditors) of the Trustee

"In the case of agreement to pledge not perfected by possession, the Act limits the validity of the 'pledgee's' interest against all creditors to 10 days, even where new value has been given by the purported pledge. Sec. 3 (1) (a).

"In such case, where the purported pledge is for old value, the effect against creditors dates only as the time of possession actually taken. Sec. 3 (1) (b). These two provisions, taken together, effectually exclude the use of pretended (or unperformed) prior agreements to pledge, dated back more than 4 months, from draining an insolvent estate in favor of particular selected creditors.

"Belated filing is also prevented from defeating general creditor's rights by relation back, Sec. 7 (1) (b); as is the taking of possession under an unfiled trust receipt transaction. Sec. 7(2).

"It limits any rights the entruster acquires without filing to a 30 day period. Sec. 8(1) and (2). It will be noted here that 'lien creditor' as used in Sec. 8(2) covers, under clause (b) of that subsection, the representatives of general creditors, whenever insolvency supervenes.

"It permits any individual creditor, after the temporary period and before filing, to acquire a lien prevailing over that of the entruster by securing the issuance of process thereafter duly served. Sec. 8 (2) (a). It will thus no longer be possible to defeat the levying creditor by giving notice as the sheriff arrives.

"It deprives the entruster of the altogether improper possibility of acting like a mere creditor while things go well, but insisting on his rights as an entruster if things go badly."