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Patrick J. McDonough

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Uniform Trust Receipts Act in Montana

The Uniform Trust Receipts Act was passed in Montana by the 1945 legislature,[1] and because the act is new to this jurisdiction there are no cases of interpretation by the Montana Supreme Court. This article is written in order to acquaint persons interested in purchase-finance agreements with the Uniform Trust Receipts Act, with the validity of the transaction as against creditors of the trustee, and with the enforcement of the bi-partite trust receipt under the Act as compared with the common law rule of the necessity of having title derived from a third party.

The history of the modern trust receipts transaction shows this type of financing instrument is of comparatively modern innovation. One of the earliest cases involving the trust receipt was *Fletcher v. Morey*,[2] a decision rendered by Justice Storey in the Federal District Court of Massachusetts. The plaintiff had loaned money to the bankrupt for the purchase of goods under his agreement to pledge his property bond as security for the loan and, meantime, to hold the bill of lading and other documents for the plaintiff's account. After having disposed of part of the goods he became bankrupt, and his assignee in bankruptcy held part of the goods and the proceeds of the other parts sold. The plaintiff brought an action in equity to establish a lien on the property and proceeds in the assignee's hands. Judge Storey upheld the bill and gave the property to the plaintiff. He spoke of the case as an "equitable lien" without determining whether it was an equitable pledge or mortgage and held in principle that it was enforceable against all except bona fide purchasers from the bankrupt for valuable consideration and without notice.[3]

Equitable mortgages of realty had long been enforced, but this appears to be one of the earliest cases in which an analogous equitable right was recognized and considered with respect to personality.[4] The first reported case where the term "trust receipt" was used appears to be *Barry v Bonninger* in 1876.[5]

[1]Ch. 147, LAWS OF MONTANA 1945.
[2]Fletcher v. Morey, 2 Storey 555.
[3]Frederick, **The Trust Receipt as Security,** 22 COLUM. L. REV. 409.
[4]**Supra,** note 2.
[5]Barry v. Bonninger (1876) 46 Md. 59.

Following Justice Storey's decision in 1848, which upheld an equitable lien on personality, we find an immediate widespread use of this type of financing instrument in the American importation trade. The way the early American traders used this type of security transaction was as follows: An importer not having sufficient ready cash would apply to a bank who in turn would negotiate with a shipper in a foreign country, the latter making the bill of lading to the order of the bank. The shipper would also draw a draft on the bank. When the merchandise arrived in this country the importer would sign a trust receipt instrument, return it to the bank and the bank would give the bill of lading to the importer who would then be able to procure the goods from the carrier. The importer would be required to pay only a portion of the actual value of the goods and the bank would release the goods to the trustee, the importer. The advantage in this was that a small businessman could carry on his business without actually investing all his money in merchandise, and would be able to resell the goods and upon such sale the bank, the entrustre, would recover its money.

The advantage of the trust receipts as a financial device in aid of business was pointed out in the case of *Century Throwing Co. v. Mullers*[6]

> "We can readily understand how the business of foreign importation by merchants and especially by manufacturers is facilitated and enlarged by making available to those of small means the credit of banking capital. The business of importation is thus extended, by not being confined to those concerns having large capital and established foreign credit."

The trust receipt is spawned from the need for credit on the one hand and the need for security other than the personal liability of the borrower on the other.[7]

The use of the trust receipt in our modern day complicated business methods can best be shown by using the automobile industry as an example. The automobile manufacturers, whose primary business is the production of automobiles and who for various reasons do not like to enter the field of financing, find this a very easy method of financing the sale of their automobiles to their various dealers. For instance, a car dealer here in Montana wishing to purchase automobiles from the manufacturer in Detroit and not having sufficient money to pay cash

[6]Century Throwing Co. v. Muller (C.C.A. 2d 1912) 197 F. 262.
[7]Frederick, **The Trust Receipt as Security,** 22 COLUM. L. REV. 395.

for the cars, or not willing to tie up all his ready cash in the cars until after each is sold may find the trust receipt transaction very convenient. The dealer, trustee, orders cars from the manufacturer in Detroit, who requires full payment for such cars. The dealer has a finance company pay the manufacturer for the cars, the manufacturer ships the cars by carrier to the dealer here in Montana, taking from the carrier an order bill of lading. The manufacturer then sends the bill of lading with sight drafts attached to the finance company, who pays the drafts when the cars arrive at their destination. The dealer upon being notified has the finance company release to him the bill of lading so that he may take possession of the cars. The dealer pays a percentage down on the cars at this time, usually fifteen to twenty per cent of the purchase price, and executes to the finance company a note for the balance. The finance company upon giving the bill of lading to the dealer simultaneously receives a trust receipt in return.

The trust receipt usually allows the dealer to take possession of the cars and place them on display. This also allows the dealer the power to resell. The risk of loss is placed on the dealer. The finance company has the power to have the cars returned to them at any time and the dealer agrees to hold the proceeds of the sale in trust for the finance company.

Perhaps the most important advantage of this type of transaction originally was that recording was not required in order to protect the entruster. More recently some states have passed laws requiring this type of business transaction to be recorded under the chattel mortgage recording statutes or to be recorded as a conditional sales contract.

In considering the Uniform Trust Receipts Act it is imperative to consider the following definitions:

> In Section 1 of the Uniform Trust Receipts Act,[8] "entruster" means the person who has, or directly or by agent takes, a security interest in goods, documents or instruments under a trust receipt transaction, and any successor in interest of such person. A person in the business of selling goods or instruments for a profit, who at the outset of the transaction has, as against the buyer, general property in such goods or instruments and who sells the same to the buyer on credit, retaining title or other security interest under a purchase money mortgage or a conditional sales contract or otherwise, is excluded.

[8]*Supra*, note 1.

> "Trustee" means the person having or taking possession of goods, documents or instruments under a trust receipt transaction and any successor in interest of such person.

The important parts of the act which will affect the general public and be of most interest to creditors of the trustee when attempting to levy or attach property in the trustee's hands are the following sections of the Uniform Trust Receipts Act, although a bona fide purchaser even in thirty days would be protected against the entruster since the trustee is given a power of sale in the agreement:

> Section 7:
> "If the entruster within the period of thirty days files as in this act provided, such filing shall be effective to preserve his security interest in documents or goods against all persons."
>
> Section 7 (2):
> "The taking of possession by the entruster shall, so long as such possession is retained, have the effect of filing in the case of goods or documents and of notice of the entruster's security interest to all persons, in the case of instruments."
>
> Section 8:
> "The entruster's security interest in goods, documents or intsruments under the written terms of a trust receipt transaction 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, documents or instruments, to the trustee and thereafter except as in this act otherwise provided."
>
> "But where the trustee at the time of the trust receipt transaction has and retains instruments the thirty days shall be reckoned from the time such instruments are actually shown to the entruster or from the time that the entruster gives new value under the transaction, which ever is prior."

How the various state recording acts affected the trust receipt was a rather interesting study prior to the Uniform Act. Some states required the instrument to be recorded as a chattel mortgage, and others required it to be recorded as a conditional sales contract. Perhaps the larger number of states regarded it as a unique security device analogous to a bailment and agency, or factoring assignment requiring no recording. The Uniform Trust Receipts Act is a compromise, for it recognizes that most such financing is short term and that recording and releasing therefrom as sales are made will be quite inconvenient accordingly. Section thirteen of the Uniform Trust Receipts Act[9] as stated below disposes

[9]**Supra,** note 1.

of the individual recording of the trust receipt and provides that a statement signed by the entruster and trustee is to be filed with the Secretary of State, the statement containing:

> "(a) a designation of the entruster and trustee, and 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."

The statement may also be filed with the registrar of motor vehicles or county clerk and recorder depending on type of goods financed and the recording is good for one year.

Prior to the Uniform Trust Receipts Act the only instance where the security title of a trust receipt holder would prevail over a creditor of the trustee was where the title was derived from someone other than the trustee. Where the title of the security holder was derived from a trustee the transaction was treated as being similar to a chattel mortgage and subject to the chattel mortgage recording statutes or void as to creditors of the trustee.

A recent California case,[10] *Chichester v. Commercial Credit Co.,* as interpreted by the Supreme Court of that state shows how the bipartite trust receipt act is enforceable and will protect the entruster from the creditors of the trustee. In this case the plaintiff, trustee in bankruptcy for the estate of X, an automobile dealer, sued the Commercial Credit Co., defendant, alleging that the automobile dealer had executed trust receipts to the defendant in order to finance the purchase of automobiles.

The bankrupt as a dealer purchased two types of automobiles, Plymouths and Chryslers. For the Plymouths the bankrupt would sign trust receipts together with promissory notes in the office of the defendant finance company, and the finance company would call the office of the manufacturer who would deliver the property to the dealer, X. When purchasing the Chrysler cars, X would place the order with the Chrysler Corporation in Detroit and after payment of the purchase price

[10]Chichester v. Commercial Credit Co. (1940) 99 P. (2d) 1083.

by the defendant, the automobiles were shipped to X, but the bills of lading were made out and sent directly to the defendant. After X had signed trust receipts for the automobiles together with promissory notes in the same amounts as the trust receipts, defendant delivered the bills of lading to X. In each instance the full purchase price of the automobiles plus freight was paid by the entruster directly to the Chrysler Corporation.

The trust receipts involved were agreements whereby X agreed to hold the designated automobiles in trust for the defendants, defendant agreeing that the trustee might sell the automobiles for not less than a minimum price, providing an equal amount of money was immediately delivered to the defendant. It was further agreed that the defendant could repossess said automobiles at any time.

The plaintiff contended that title to the automobiles never vested in the defendant and that in reality the so-called "trust receipt" was a chattel mortgage and void for failure to comply with the California Chattel Mortgage Recording Act.[11] The court refused to uphold the plaintiff's contention that the repossession by the defendant of the automobiles which the bankrupt held under the trust receipt was a preference in violation of U. S. Bankruptcy Act[12] and upheld the bi-partite trust receipt as the Uniform Trust Receipts Act[13] provides.

Still a more recent case than the *Chichester* case, decided in 1940, is the California case of *C. I. T. Corporation v. Commercial Bank of Patterson.*[14] The court held on the enforcement of the bi-partite trust receipt transaction that it was provided for in the Uniform Trust Receipts Act. A retail automobile dealer had possession, but not title to automobiles purchased by him for which trust receipts were executed to the finance company, which had title and right to repossess the automobiles at its pleasure. The finance company's claim to the automobiles was superior to that of the bank from which the dealer borrowed money secured by bill of sale covering the same automobiles, because the dealer's possession was insufficient to give rise to a valid trust receipt transaction between dealer and bank. Thus the validity of the bi-partite trust receipt under the Uniform Trust Receipts Act was further estab-

[11]Cal. Civil Code 1937, §3440.
[12]20 STAT. 99 (1878), 11 U.S.C.A. §96 sub a.
[13]Cal. Civil Code 1937, §3014.
[14]C.I.T. Corporation v. Commercial Bank of Patterson (1944) 149 P. (2d) 439.

lished. This court said in regards to a trust receipt as compared with other security devices as follows:

> "While the security interest afforded by a trust receipt prior to the enactment of the Uniform Law was somewhat similar to many other forms of chattel security, it may be distinguished from such transactions as a mortgage, pledge, or condition of sale. In the case of a mortgage a lien is given by the mortgagor to the mortgagee in order to secure the latter for the performance of an obligation by the mortgagor, who retains possession of the property. The trust receipt does not conform to a pledge since in the case of a pledge the security depends upon the possession of the goods by the person secured whereas in the case of a trust receipt the entrustor does not have possession of the goods. In the case of a conditional sale, possession may not ordinarily be retaken until there is a default in the contract; whereas under a trust receipt transaction possession may be taken at any time, in the case of a chattel mortgage title is found in the mortgagee prior to the mortgage."

What constitutes a trust receipt transaction may best be shown by the following sections of the act.[15]

> Section 2. . Subdivision 1. "A trust receipt transaction within the meaning of this act is any transaction which an entruster and a trustee are parties, for one of the purposes set forth in subdivision 3, whereby
>
> (a) the entruster or any third person delivers to the trustee goods, documents or instruments in which the entruster (i) prior to the transaction has, or for new value (ii) by the transaction acquires (iii) as a result thereof is to acquire promptly, a security interest; or . . .
>
> (ii) be prusuant to a prior or concurrent written and signed agreement of the trustee to give such a writing.
>
> "The security interest of the entruster may be derived from the trustee or from any other person, and by pledge or by transfer of title or otherwise.
>
> "If the trustee's rights in the goods, documents or instruments are subject to a prior trust receipt transaction, or to a prior equitable pledge, section 9 and section 3, respectively, of this act, determine the priorities."

To date, the trust receipt has not been widely used in Montana. The passage of the Uniform Trust Receipts Act should see a greatly

[15]*Supra*, note 1.

increased volume of business being financed by this type of security device. It appears that this would be a very advantageous method of conducting business by financing companies as well as a retail dealer, both parties being able to take advantage of the security offered along with the protection afforded without the inconvenience of the regular recording statutes.

Patrick J. McDonough.