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The Trust Receipt—Its Possible Legal Status in Washington

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THE TRUST RECEIPT—ITS POSSIBLE LEGAL STATUS IN WASHINGTON—Within a period of comparatively recent date there has crept into commercial usage an instrument known as the trust receipt.¹ Because of the extensive use now being made of the trust receipt in Washington, it is well to become acquainted with some of its legal aspects.

In British law the rights of the lending bank under the trust receipt have been steadfastly upheld on the ground that the trust receipt is a necessary instrument of commerce.² This view has been quite generally followed in the American courts, with the difference, however, that the courts deem it a part of their judicial duty to decide whether these instruments (which have nothing to do with technical trusts) are chattel mortgages, contracts of conditional sale, or something different from either. Trust receipts have been held to be conditional sales in those jurisdictions where, at the time of the decisions, conditional sale contracts did not have to be recorded.³ On the other hand, at least one writer contends that the creditor (the banker) is a mortgagee, and that the trust receipt arrangement constitutes, in legal effect, a chattel mortgage.⁴ At any rate the earlier view was in favor of the banker, one court going so far as to classify the trust receipt as a bailment in order to avoid the harsh rule making conditional sales fraudulent.⁵

Not all of the courts, however, have allowed themselves to be annoyed by the classification problem. The federal courts have decided, instead, that the trust receipt is an instrument *sui generis*, and perfectly legitimate when confined to its proper use.⁶ But the trust receipt is not always confined to its proper use; and hence the question arises: what shall be done in a case where the dealer receives the goods directly from the manufacturer, giving the latter a trust receipt therefor wherein it is expressly stated that the title to the property is reserved in the manufacturer as a security for the purchase price; or,

¹ The trust receipt was originally employed in importing transactions. In pursuance of the agreement between the buyer and his banker, the seller delivered the goods or bills of lading to the banker, who accepted or paid the seller's draft. The goods or documents of title were then turned over by the banker, to the buyer against a trust receipt in which the latter acknowledged the banker's title and agreed to hold the goods for a special purpose, as "trustee" of the banker.

² *In re Young, Ex parte Carter* (1905) 2 K. B. 772; *David Allester Ltd. Case*, (1922) 2 Ch. 211.

³ *Dows v. Nat. Exchange Bank*, 91 U. S. 618, 23 L. ed. 214 (1875) *Moors v. Kidder*, 106 N. Y. 32, 12 N. E. 818 (1887) *Farmers Nat. Bank v. Logan*, 74 N. Y. 568 (1878) *Barry v. Boninger*, 46 Md. 59 (1876), *Moor v. Wyman*, 146 Mass. 60, 15 N. E. 104 (1888), *New Haven Wire Co. Cases*, 57 Conn. 352, 18 Atl. 266 (1888).

⁴ See 22 Col. L. Rev. 395, 546 (1922). *The Trust Receipt as Security*, by Mr. Karl Frederick.

⁵ *Brown v. Billington*, 163 Pa. 76, 29 Atl. 904 (1894)

⁶ *Century Throwing Co. v. Muller* 197 Fed. 252, 116 C. C. A. 614 (1912) *In re Cattus*, 183 Fed. 733, 106 C. C. A. 171 (1910), *Charavay & Bodvun v. York Silk Mfg. Co.*, 170 Fed. 819 (1909).

if a banker finances the deal, what shall be done where the banker receives his title from the dealer instead of from the manufacturer? Is there anything in such a transaction to distinguish it from a chattel mortgage and thus enable it to escape the condemnation of the recording statutes? Clearly not; and the courts are carefully examining every trust receipt transaction for just such thinly-veiled chattel mortgages and conditional sales.

Judging by the number of cases in which this spurious use of the trust receipt has been the subject of litigation, it would seem that bankers and business men are slow to grasp the distinction between a trust receipt given for goods the legal title of which had passed to the bank direct from the debtor himself, and a trust receipt for goods whose title passed from a third person, usually a foreign exporter or a domestic manufacturer, to the bank. It is the failure to observe this distinction to which can be attributed much of the present-day hostility to the use of the trust receipt, which ordinarily is not recorded.

While the banker's rights have been upheld against parties claiming under the importer as judgment or attaching creditors,⁸ pledges,⁹ lienors,¹⁰ and trustees in bankruptcy,¹¹ there does not, as yet, seem to have arisen a case wherein there had to be considered the rights of one who, without knowledge of the relationship existing between the banker and the importer by virtue of the trust receipt, in good faith, buys the goods from the importer giving full value therefor, only to discover that the importer never had the title to the goods, or authority to exercise any rights of ownership over them.¹² However, there are a few cases so closely related to this precise point that it seems entirely possible to formulate a rule applicable to this particular state of facts.

Thus, it has been held that the claims of the banker are superior to those of an innocent purchaser for value of the importer's claim against the purchaser of the goods from such importer.¹³ In another case¹⁴ the lending bank was allowed to prevail against the claims of an innocent pledgee of the importer, regardless of the legal principle that upon a question of priority a pledgee stands upon the same footing as a purchaser, and, where the legal owner has put it into the power of the debtor to make a fraudulent pledge, the pledgee's claim is superior to that of the real owner.¹⁵ Finally, in Massachusetts it

⁷ *In re Gerstman*, 157 Fed. 549 (C. C. A. 2d, 1907) *In re Shulman*, 206 Fed. 129 (1913) *Amer. & Br. Sec. Co. v. Amer. & Br. Mfg. Co.*, 275 Fed. 121 (1921) *Salinas City Bank v. Graves*, 79 Cal. 192 (1889) *Bell v. N Y Safety Steam Power Co.*, 183 Fed. 274 (1910) *Jordan v. Federal Trust Co.*, 296 Fed. 738 (1924) *In re Schuitig*, 1 F (2d) 443 (1924).

⁸ *In re Reboulin Pils & Co.*, 165 Fed. 245 (1908).

⁹ *Moors v. Kidder* see note 3, *supra*.

¹⁰ *Century Throwing Co. v. Muller* see note 6, *supra*.

¹¹ *In re Cattus*, see note 6, *supra*.

¹² The reference here is to a *bona fide* purchaser for value.

¹³ *In re Dunlap Carpet Co.*, 206 Fed. 726 (1913).

¹⁴ *Moors v. Kidder*, see note 3, *supra*.

¹⁵ 31 Cyc. 811.

has been held¹⁶ that a bank taking a trust receipt to insure realization of advances made by it to finance an importation of goods is not liable for reimbursement to a customhouse broker who, without knowledge of the banker's interests and at the request of the importer, advanced money to release the goods from the customhouse.

To be sure, in no one of these cases was the injured person a *bona fide* purchaser of the goods, because he was not an outright purchaser thereof; yet it cannot be denied that in each instance he stood in a legal position similar to that of a *bona fide* purchaser inasmuch as he parted with value in actual reliance upon the ostensible ownership of the specific goods in the importer. If the courts were inclined to regard a trust receipt as invalid against a *bona fide* purchaser, here was ample opportunity to express such an inclination.

From the foregoing decisions it may be justly concluded that, as the use of the trust receipt has become more common, the courts have come to modify in some particulars the policy underlying the Statute of Frauds, by which the divorce of title from possession is declared either evidence of fraud or fraudulent *per se*, and to resort to the doctrine that possession in one person, which is consistent with an agreement between the parties, is not inconsistent with the actual title in another, and will be supported for the purposes stated in the contract, even against a *bona fide* purchaser from one having possession without title.¹⁷

What view will Washington take? Under certain provisions of the Uniform Acts relating to Bills of Lading,¹⁸ Warehouse Receipts,¹⁹ and Sales,²⁰ very definite limitations²¹ will have to be placed upon the banker who, though he reserves the actual title to himself, intrusts the importer with the documents of title, solely on the strength of an unrecorded trust receipt.

It is hardly possible that our Court would classify the trust receipt as a chattel mortgage, because such a classification would have to be based upon a theory of mortgages to which the Court stands positively opposed, namely, that the legal title to the property mortgaged passes to the mortgagee (the banker).²²

There remains the possibility that the Court might treat the trust receipt as a contract of conditional sale and thus compel its being

¹⁶ *Downing Co. v. Shawmutt Corp'n*, 245 Mass. 106, 139 N. E. 106 (1923).

¹⁷ This doctrine is enunciated in *Century Throwing Co. v. Muller*, see note 6, *supra*.

¹⁸ Rem. Comp. Stat., § 3678; P. C. § 459.

¹⁹ Rem. Comp. Stat., § 3627 P. C. § 7181.

²⁰ Laws 1925, Ext. Sess., Ch. 142, p. 355, §§ 30, 31.

²¹ These limitations are discussed in 8 MINN. L. REV. 144 (1924).

²² *Marsh v. Wade*, 1 Wash. 538, 545, 20 Pac. 578 (1889) *Richter v. Buchanan*, 48 Wash. 32, 92 Pac. 782 (1907). The old common law doctrine that a mortgagee becomes the owner of the legal title is rapidly losing ground, even in its application to chattel mortgages; while the modern trend is, as in this State, to treat the chattel mortgage as creating a lien merely. For an alignment of the states on this question see 11 C. J. 399, notes 2 and 3.

recorded. It has been forcibly pointed out, however, that it is not a conditional sale contract.²³

Although our Court may hesitate to adopt the bold, though very practical, view of placing the trust receipt in a category by itself and uphold it as an established and highly useful commercial instrument, because it may be subjected to the criticism of being an indulgence in a "bit of legislation,"²⁴ yet, on the contrary, it may be said that it is just as much a "bit of legislation" for courts to construe an instrument to be that which it was never intended to be, and from which it differs in certain marked aspects, *viz.*, a chattel mortgage or a conditional sale.

If the trust receipt is indeed "a fraud upon the law," as one judge²⁵ has termed it, the use of which, if not actually declared illegal, ought to be encompassed by the strictest regulations, the matter would seem to be for the legislature to regulate. In that way, and only in that way, will the trust receipt be recognized for what it really is—an anomalous contract relation.

In conclusion, it is to be hoped that the course of legal development will continue to be in the direction of recognizing, separating and perfecting the security interest in its security relation and functions, and to regard the trust receipt as distinct from the chattel mortgage, conditional sale, bailment or pledge, and consider it as an instrument *sui generis*, perfectly effective within its limits. Thus it will be possible to raise the trust receipt to somewhat the same level as other documents of title, such as the warehouse receipt and the bill of lading, which today afford the banker ample security for his loan.

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²³ "The consideration is furnishing funds, not goods. A suit brought by the security holder would not be for goods sold and delivered, but money lent to or furnished the buyer. The buyer is purchasing from the original seller, and not from the lender. Should the goods fail to reach the lender, the debtor would nevertheless be liable." 13 CAL. L. REV. 333 (1925).

²⁴ 6 CORNELL L. Q. 168, 175 (1921).

²⁵ Judge Hough in the *Liberty Silk Case*, 162 Fed. 844 (1907).