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Conditional Sales—Legislation in the State of Washington—Recent Legislation, Particularly Where Personality is Attached to Buildings on Realty

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COMMENTS

CONDITIONAL SALES—LEGISLATION IN THE STATE OF WASHINGTON—RECENT LEGISLATION, PARTICULARLY WHERE PERSONALTY IS ATTACHED TO BUILDINGS ON REALTY

It is a well recognized principle of the common law that as between the vendor and vendee in a transaction involving property, they may by agreement fix the incidents which shall attach.[1] The law is replete, however, with cases where a party in possession using the property creates a more or less deceptive appearance

[1]In the case of fixtures, see 34 MICH. LAW REVIEW 427, and n. 3; 83 U. of PA. L. REV. 916, n. 4, four cases cited.

as to the ownership of the property so far as third parties are concerned. As between the vendor and a third party who has been misled, the law has taken into consideration not merely the objective incidents such as use and possession, but in addition the balance of social, particularly business, convenience to vendors and third parties generally. Sometimes the third party is protected; sometimes the vendor. In the case of the conditional sale, the vendor was with few exceptions protected at common law, the rationalizations of estoppel, apparent ownership, and constructive fraud being urged in vain. With the intention of protecting both the vendor and the third party so far as possible, resort was made to recording and filing acts for the purpose of giving knowledge to third parties. These acts qualified the rights of the vendor unless so recorded or filed. While such acts have been adopted in most of the states, there is still some question as to the policy of requiring filing or recording due to the fact that they place a restraint upon merchandising because of the consequent reflection on the credit of the vendee and the additional costs involved, and possibly the further fact that the reliance by third parties is largely fictional rather than real. Accordingly a number of the states still protect the vendor without the necessity of recording or filing.

The first act passed in the state of Washington in 1893[2] was quite typical of the usual statute except that the conditional sale was made absolute to *all creditors* or purchasers in good faith, and the further provision that the conditional sale was to be *recorded,* the auditor to charge the same rates as were allowed for recording deeds of real property.

The second act, passed in 1903,[3] amended the former act by protecting the additional class of *encumbrancers* and limited protection to *subsequent* creditors rather than *all* creditors. Further the auditor was required to *merely file* the instrument, keeping an alphabetical index, and was to charge the sum of twenty-five cents for each instrument. The first provision of this amendment is in accord with the usual statutes as to the parties protected and the effect of the second provision, in requiring only filing, made possible a nominal cost.

The next act, passed in 1915,[4] again amended the provision as to parties protected by protecting subsequent creditors, *whether or not such creditors have or claim a lien upon such property.* Prior to this legislation the Washington Court had held that a chattel mortgage was valid as to creditors other than those who had acquired some form of lien upon the mortgage property, whether the mortgage was properly recorded or not.[5] It had also held that an unrecorded mortgage might, after the ten-day period provided by the statute, be recorded and become effective after the date of such recording as to all creditors both prior and subsequent, except such creditors as may have acquired a lien prior to the

[2]Laws of Washington 1893, Chap. 106.
[3]Laws of Washington 1903, Chap. 6.
[4]Statutes of Washington 1915, Chap. 95.
[5]Heal v. Evans Creek Coal and Coke Company, 71 Wash. 225, 128 Pac. 211 (1912).

filing.[6] Following the adoption of this statute, the same amendment being made both with respect to conditional sales and chattel mortgages, Justice Mackintosh in *Clark v. Kilian*[7] made the following statement: "In view of these decisions, and with the obvious purpose of changing the rule they announced, the legislature, in 1915, passed the act which provides that a chattel mortgage not filed within ten days from the time of its execution is void 'as against all creditors of the mortgagor, both existing and subsequent, *whether or not they have or claim a lien upon such property,* and against all subsequent purchasers, pledgees, and mortgagees and incumbrancers for value in good faith . . .' Under this statute, a chattel mortgage not recorded within the time is void as to all the persons mentioned, and as to them is of no effect, even though it may be filed subsequently to the ten-day period. The belated filing may carry actual notice to subsequent purchasers, pledgees, mortgagees and incumbrancers for value so as to take them out of the protection of the 'good faith' clause of the statute. As we have held in *Othello State Bank v. Case Threshing Machine Co.*[8] citing several decisions of this court, 'good faith' includes 'without notice.'" While this decision was made in the case of the chattel mortgage, the similarity of the provisions and purposes of the amendments would undoubtedly warrant the same construction in the case of a conditional sale.

The next act passed was in the extraordinary session of 1925,[9] which provided that in case a vendor in a conditional sales contract assigned the contract to secure a debt or obligation, the assignee should have the right to enforce all the vendor's remedies under the contract and if the contract and/or assignment was filed, the assignee should have a lien upon the property as against the vendor and his creditors and subsequent purchasers and encumbrancers, which lien might be enforced as a chattel mortgage is enforced. It is to be observed that this act was limited to assignments *for the security of a debt or other obligation* by the vendor and accordingly did not authorize the filing of an absolute assignment.[10] This act was in turn amended in 1937,[11] first by providing that if the assignment by the vendor was to secure a debt or other obligation, it made no difference whether the assignment was or was not *absolute upon its face.* Further, that the assignee could enforce all the vendor's remedies under the contract and would have the lien upon the property covered as against the vendor and *any subsequent assignee thereof,* the creditors and subsequent purchasers and encumbrancers of either, which lien could be enforced as a chattel mortgage *and that no filing of said assignment was necessary.* Still further, it provided

[6]Pacific Coast Biscuit Company v. Perry, 77 Wash. 352, 137 Pac. 483 (1914); Watson v. First National Bank, 82 Wash. 65, 143 Pac. 451 (1914); Keyes v. Sabin, 101 Wash. 618, 172 Pac. 835 (1918).

[7]Clark v. Kilian, 116 Wash. 532, 533, 534, 199 Pac. 721 (1921).

[8]Othello State Bank v. Case Threshing Machine Co., 113 Wash. 680, 194 Pac. 563 (1921).

[9]Laws of Washington 1925, Chap. 120.

[10]Flynn v. Garford Motor Company, 149 Wash. 264, 270 Pac. 806 (1928).

[11]Laws of Washington 1937, Chap. 196, § 2.

that the assignee would not have to take dominion and control over the contract or the proceeds thereof and that he did not have to contract to prevent the mingling by the assignor of the proceeds thereof amongst his funds or placement of the same in his bank account. These provisions are self-explanatory. In general, it perhaps should be noted that the *first assignee of such a contract secures his rights regardless of filing and prevails over a subsequent assignee,* thus settling a controverted question among the different jurisdictions.

The major changes, however, in the amendments to the Washington Conditional Sales Act were made through the enactments made by our legislature in the sessions of 1933 and 1937.[12] The session laws of 1933 amended section 3790 of Remington's Compiled Statutes by the addition of the following provision:

> "Every such contract for the conditional sale or lease of any personal property, except machinery, apparatus or equipment to be used for manufacturing or industrial purposes, attached or to be attached to a building, whether a fixture at common law or not, shall be absolute as to all subsequent bona fide purchasers or encumbrancers of such building and the land on which it stands, unless such contract or lease shall also contain a sufficient legal description of the real estate which said building occupies, and shall be filed and recorded as provided in section 2 of this act."

Section 3791[13] of Remington's Compiled Statutes was also amended by providing for the record of the instrument mentioned in the preceding provision. The section reads:

> "In the case of an instrument for the conditional sale or lease of personal property, except machinery, apparatus or equipment to be used for manufacturing or industrial purposes, attached or to be attached to a building, such instrument shall, in addition to filing and indexing as herein provided, be indexed and *recorded* in the record of mortgages in the auditor's office in the county wherein the land which said building occupies is situated; and the fees for indexing and recording shall be the same as for real estate mortgages."

In the session of 1937,[14] section 3790 of Remington's Revised Statutes was still further amended by a rather exceptional provision which reads as follows:

> "Provided, however, that nothing in this section contained shall be construed to require such filing or recording of any conditional right to purchase, wherein the total designated *unpaid purchase price does not exceed the sum of fifty dollars* ($50) and such contracts or leases shall be valid as to all bona fide purchasers, pledgees, mortgagees, encumbrancers and subsequent creditors: Pro-

[12]Laws of Washington 1933, Chap. 129, and Laws of Washington 1937, Chap. 196.

[13]Section 2 of the foregoing act.

[14]See note 11, *supra.*

> vided, further, that in computing said 'total designated unpaid purchase price' there shall be added to said purchase price designated in any such contract the designated unpaid purchase price set forth in any other contract of conditional sale executed between the same vendor and vendee as a part of the same transaction and if the total of all exceeds said sum of fifty dollars ($50) each of said contracts of conditional sale shall be absolute as hereinabove provided unless filed or filed and recorded as hereinabove provided."

The last amendment, exempting conditional sales from filing where the amount involved is not over fifty dollars ($50), will be first considered. Its policy is obvious. The small amount involved, the consequent relative higher cost of filing, and the fictitious reliance of third parties, underlie a policy that the burdens incident to filing do not warrant filing in order to protect the rights of the third party. An examination of the statutes, however, shows there to be little precedent in this country for such a limitation. An earlier recording statute in Maine applied only where the agreement was made on a promissory note for more than thirty dollars ($30), which was superseded by a general filing statute.[15] In the District of Columbia, the provision for filing applies only where the purchase price exceeds $100.00.[16] The Idaho Code[17] provides that its enactment with respect to conditional sales contracts shall not apply to a conditional sale of "household goods and furniture, musical instruments, motor vehicles, farm implements and machinery, property exempt from attachment or execution, *nor to any conditional sale where the consideration is less than* $100.00." It may be observed in passing that a number of jurisdictions make similar exceptions in the case of household goods, as provided in the Idaho Statute.[18] Such limitations express obvious policies.

Further it may be noted that the fifty dollar ($50) exception is made to and expressly qualifies the entire section of Remington 3790, making no distinction as to whether personalty is attached or not to be attached to buildings on the realty. It is hardly reasonable, however, to presume that our courts will hold that if personalty becomes so identified with the realty as to become a part thereof and is not severable except with material injury to the freehold, that the conditional sales vendor will be protected. The common law view was that where goods are so closely affixed as to be swallowed up in the realty, they have no longer any need for existence separate from the land.[19] The Uniform Conditional Sales Act is to the same effect.[20] It is unfortunate in this respect that our amendment, in stating that such conditional sales need

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[15]Chap. 32, Laws of 1895.

[16]1929 Code of the District of Columbia, Title 25, § 179.

[17]General Laws of Idaho 1932, § 62-805.

[18]Connecticut Public Acts 1895, Chap. 212; New Hampshire Public Statutes 1901, Chap. 140; New York, Abolished by Laws 1905, Chap. 503.

[19]Bogert, *Commentaries on Conditional Sales*, 1924, 2a U.L.A. 66 cases cited.

[20]Section 7, Uniform Conditional Sales Act.

not be filed, should have added the clause *that they were valid.* If the act be literally construed, this will lead to the absurd result that personalty attached to realty, although identified with the realty and not severable except with material injury to the freehold, may be claimed by the vendor under a conditional sales contract without even filing, as against subsequent purchasers and encumbrancers of the realty. It is submitted that the act should be amended in this respect either by striking the clause giving validity or by making an exception when personalty is so attached to realty.

This suggests finally the consideration of the provision in the amendment of 1933 which provides for *recording* "a conditional sale or lease of any personal property except machinery, apparatus, or equipment to be used for manufacturing or industrial purposes, attached or to be attached to a building whether a fixture at common law or not." This is not an attempt to solve a new problem, but rather one of a number of attempts to solve by recordation the problem raised when a lien is placed on personalty attached to or to become identified with realty. This was at common law usually determined by finding whether or not the personalty had become a fixture, the weight of authority being to the effect that if found to be a fixture, the third party purchaser or encumbrancer would be protected.[21] The difficulty in the application of such a rationalization is in the determination of the question whether the personalty has become a fixture. The test usually suggested to furnish the safest criterion of a fixture is: (1) Actual annexation to the realty or something appurtenant thereto; (2) Appropriation to the use or purpose of the realty with which it is connected; and (3) The intention of the parties making the annexation to make the article a permanent accession to the freehold—this intention being inferred from the *nature* of the article affixed, the relation and *situation* of the *party* making the annexation, the structure and mode of annexation, and the purpose or use for which the annexation has been made.[22]

One writer, in commenting on this test, says that "in its essence, this doctrine may be succinctly propounded in this form: Did the person who annexed the disputed chattel intend to make a permanent annexation to the freehold? The intention is to be sought not subjectively, but objectively, judged in the light of the surrounding circumstances and with particular reference to the mode of annexation and the extent to which the chattel is appropriate to the purpose or use to that part of the realty to which it is attached."[23] It would seem clear that so far as third parties are concerned, the objectively expressed intention should be the determinative test. Particularly is this true as it permits flexibility.

One of the chief reasons for the confusion in the law of fixtures

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[21]TIFFANY REAL PROPERTY, second edition, § 271, p. 922 and cases cited n. 4.

[22]Teaff v. Hewitt, 1 Ohio St. 511, 530 (1851), a leading case, and see an excellent discussion in 12 N. Y. U. L. Q. REV. 66.

[23]4 BROOKLYN L. REV. 193.

today is the blind adherence of the courts to the doctrine of *stare decisis*. Having once decided that a certain chattel was not a fixture, it certainly did not follow that it might not be a fixture when attached under different circumstances, particularly where a change in custom and usage. There may be need for legislative guidance in order to release the courts from the bonds of *stare decisis*.[24]

Washington has from an early time apparently adopted the objective test of intention.[25] Emphasis, however, is made on the mode and sufficiency of annexation, and it is stated that personal property is generally considered not a fixture if the annexation is such that it can be removed without material injury to the realty.[26] As between the seller and the buyer of chattels which are subsequently annexed to realty by the latter, the fact that they are sold on a conditional sale contract was usually regarded as equivalent to an agreement that the articles should after annexation retain their character as personalty.[27] Such an agreement was recognized as effective as between the parties thereto unless the mode of annexation was such as to wholly deprive the articles of the attributes of personal property. It would seem then that third parties, purchasers or encumbrancers, with notice would acquire only the rights of the conditional sale vendee. Without notice most courts held the *third party* encumbrancer or purchaser was protected on the theory that the seller consented at least impliedly to the annexation, thus justifying an inference by the purchaser or mortgagee that the articles were permanent improvements. A few jurisdictions, including New York, prior to its adoption of the Uniform Conditional Sales Act, protected the seller on the basis that the buyer could convey no greater interest than he himself had in the articles.[28] It does not appear that this question has been squarely presented to our Supreme Court. In *Boeringa v. Perry*[29] the court suggests by implication at least that the third party would be protected, although in the instant decision it was held that pipe embedded in real estate could be removed without permanent (material) injury to the real estate and the chattel mortgagee was protected.[30] It is, of course, assumed that if the personalty has not become a fixture, the third person, purchaser or encumbrancer, of the real estate will not be protected.

Assuming that the personalty has become a fixture, the question arises as to how far filing or recording acts may assist the vendor and protect third parties. In this respect again, there is the greatest diversity of judicial opinion as to the effect of filing or recording a chattel mortgage or conditional sale contract covering a fixture. With the exception of those states in which the Uniform Conditional Sales Act or statutes of a similar nature are in force,

[24]Massachusetts Laws 1927, Chap. 260.

[25]Washington National Bank v. Smith, 15 Wash. 160, 45 Pac. 736 (1896).

[26]See German Savings and Loan Society v. Weber, 16 Wash. 95, 47 Pac. 224 (1896), which is the first of a long line of cases.

[27]10 MINN. L. REV. 348.

[28]Godard v. Gould, 14 Barb. (N. Y.) 662, 666 (1853).

[29]96 Wash. 57, 164 Pac. 773 (1917).

[30]For cases in the different jurisdictions, see 13 A.L.R. 448.

the weight of authority appears to favor the view that filing or recording as personalty is not constructive notice to subsequent mortgagees or purchasers of the realty to which the fixture is annexed.[31] The reason assigned is that the third party encumbrancers or purchasers should not be expected to search records relating to personal property on the basis that instruments relating to real estate should appear in real estate records. A number of courts, however, treat the filing or recording of personalty as constructive notice on the basis that it is not too much of a burden for the third party buyer or encumbrancer to search the chattel mortgage or conditional sales records. This question, of course, is purely a matter of policy.

The Uniform Conditional Sales Act (Section 7) patterned after statutes existing in Massachusetts, New York, Oregon, and Pennsylvania prior to the drafting of the Uniform Conditional Sales Act, protects such parties by requiring conditional sales of personalty annexed to real estate to be recorded or filed in the real estate records in order to give notice to purchasers or encumbrancers of real estate. Such legislation seems desirable although the states adopting the Uniform Conditional Sales Act still seem to have difficulty in determining its application. Both Pennsylvania and New York have repeatedly amended the Uniform Act in this respect.[32] The Uniform Conditional Sales Act, Section 7, provides for three situations: (1) Where the goods are so affixed to realty as to become a part thereof and not to be severable without material injury to the freehold, the reservation of property is void as against any person who has not assented to the reservation. Recording does not help the conditional sale. (2) Where the goods are so affixed to realty as to become a part thereof, but severable without material injury to the freehold, the reservation of property is void as against subsequent bona fide purchasers of the realty unless the conditional sale contract is filed as a realty record. (3) Where a contractor affixes goods to the realty of another, the latter is protected as against the conditional seller unless the contract is filed as a realty record before the goods are affixed.

Professor Bogert who drafted the Act indicates that its purpose was to require filing of the conditional sales contract as a realty record, where the article annexed became a part of the realty under the law of fixtures.[33] If such is the case, this undoubtedly will lead to confusion in states which have different rules for determining the question as to what constitutes a fixture. For example, in the State of Washington,[34] where it is generally considered that personalty is not a fixture, if the personalty is such that it can be removed without material injury to the realty, the implication is that if it could not be, it would be a fixture, and accordingly the Act would exclude filing for record. However,

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[31]13 A. L. R. 484; 73 A. L. R. 742, 743, 748; 88 A. L. R. 1344; 111 A. L. R. 378; Abramson v. Penn. & Co., 156 Md. 186, 143 Atl. 795 (1928).

[32]U. L. A. Vol. 2, Conditional Sales 1936 Supplement, pp. 7, 70.

[33]13 CORNELL L. Q. 435, 437.

[34]See n. 22 *supra*, 1 Ohio St. 511, 526.

it is to be assumed that the different jurisdictions will follow prior constructions of the Act in order to secure uniformity, this being required in the Act. It is submitted that the real test in such cases should be: (1) If the property has become so submerged or identified with the realty that the property could not be removed except with material injury, the third party is justified in believing and relying on the property as being permanently attached. Filing will be of no avail. (2) If the property is of such a character and attached in such a manner that from custom and usage the third party may be in doubt as to whether the property may be severed, filing should be provided for notice to third parties. (3) If the personalty would customarily not be regarded as a fixture, filing should not be necessary so far as third party purchasers or encumbrancers of the real estate are concerned.[35]

This leads then to the consideration of our legislative provision in 1933. An examination of the conditional sale statutes in the various states discloses but one statute similar to the provisions of our statute. In 1904 a statute was adopted in New York.[36] This statute provided that "every such contract for the conditional sale of any goods or chattels attached, or to be attached, to a building, shall be void as to subsequent bona fide purchasers or encumbrancers of the premises on which said building stands and as to them the sale shall be deemed absolute unless the contract shall have been duly filed." Obviously the question at once arises, what is meant by the words, "Attached or to be attached"? The New York Court held that the statute was intended to apply to those articles only where attached in such manner as to become fixtures using the old criteria for fixtures—annexation, adaptability, and intent.[37] The act has, however, been superseded in New York in 1922 by the adoption of the Uniform Conditional Sales Act, the test in Section 7 being thereafter applied. It has been felt that the adoption of the uniform act did not really change the construction which had been made of the former act.[38]

It will be observed, however, that our act contains the additional words *"whether a fixture at common law or not."* This then presents the problem as to what construction shall be made of our act, for no doubt judicial construction will be required of the words, "attached or to be attached, *whether or not a fixture.*" It is hardly reasonable to presume that our court will hold that this section was intended to apply to any and all personalty, no matter how attached, particularly where by custom and usage

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[35]An excellent discussion of this question will be found in 4 BROOKLYN L. REV. 177. See also 11 N. Y. U. L. Q. REV. 560 at page 582, where it is said: "The test amounts to this: what would an ordinary buyer, mortgagee, or judgment creditor reasonably expect to be a part of property to be sold, mortgaged or levied upon? Attachment to realty is the prerequisite, dedication to the service of the realty by the owner of all is the rational basis of the rule."

[36]New York Laws 1904, Chap. 698, § 912; New York Laws 1909, Chap. 45, 62, The Personal Property Law.

[37]Kirk v. Crystal, 118 App. Div. 32, 103 N. Y. S. 17 (1907), aff. in 193 N. Y. 622, 86 N. E. 1126 (1908); also see discussion 14 CORN. L. Q. 334 *et seq.*

[38]See n. 37 *supra*, 14 CORN. L. Q. 334 *et seq.*

removal is contemplated. On the other hand, if it does not so hold, there will still be a zone of uncertainty where the vendor can not protect himself except by recording, and if he does not record, the third party purchaser or encumbrancer will in turn be in doubt. Perhaps the test should be that in any case where there is a reasonable doubt from an objective standpoint based upon usage, custom, the nature of the article, and the attendant circumstances, as to whether or not the personalty is permanently attached, it should make no difference that the personalty can be removed without material injury to the property and such conditional sales should be recorded as well as filed. This seems the reasonable construction.

It is also reasonable to assume that our court will construe the recording act to be unavailable to protect the vendor where the personalty has become identified with the realty. This again will require construction through case law by the court as to the border line cases. Again it is to be noted that the act applies to personal property *attached to a building*. The question arises, what about personalty attached directly to the real estate and so attached that because of attendant circumstances, it cannot be removed without material injury to the real estate. And further, an exception is made to the provision requiring recording, namely, "material, apparatus, or equipment to be used for manufacture or industrial purposes." What personalty comes within this exception will also require judicial construction.

It is to be expected that in legislation respecting fixtures combined with recording and filing acts, both of which present complicated questions and conflicting policies, that there must be much experiment before such legislation will be satisfactory. It would seem, however, that in view of the study and care used in drafting the Uniform Conditional Sales Act, particularly with the experience and the decisions in the jurisdictions adopting same, and the provision for uniform construction, that we might better in our pioneering stage have used that act as our model. The present act will, until case decision determines its application, render uncertain both as to the vendor and the purchaser or encumbrancer what conditional sales of personal contracts must be recorded as against the real estate. It is true that if the vendor feels uncertain, he may pay the additional fee for recording his contract, but such fees are burdensome and tend to burden full and free alienation of personal property. Legislation at its best is merely an experiment and should supersede the common or case law only after the most cautious, studied and painstaking consideration.

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