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Factors--Tobacco Warehousemen--Conversion of Mortgaged Property

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FACTORS—TOBACCO WAREHOUSEMEN—CONVERSION OF MORTGAGED PROPERTY—An action was brought in the United States District Court, Eastern District of Kentucky, by the United States as mortgagee against a Kentucky tobacco warehouse company for conversion of mortgaged tobacco. In 1952 the plaintiff loaned $2600.00 to the mortgagors. In 1955 the mortgagors, as security for this loan, executed to the plaintiff a crop and chattel mortgage which was duly recorded in the county in Indiana in which the mortgagors resided and in which the crops were to be raised. The mortgagors raised a crop of tobacco during 1955 and consigned it, without knowledge or consent of the plaintiff mortgagee, to the defendant's warehouse in Kentucky, there to be sold. The defendant, having no actual notice of the mortgage, sold the tobacco in the regular course of business and accounted to the mortgagors for the proceeds. No accounting having been made to the plaintiff-mortgagee by the mortgagors nor anyone on their behalf, it brought this action seeking to recover the proceeds of the sale from defendant-warehousemen. Defendant relied solely upon the earlier Kentucky case of *Abernathy & Long v. Wheeler, Mills, & Co.*[1] in which the Kentucky Court of Appeals held that where a tobacco warehouseman receives tobacco from the apparent owner and, having no interest therein himself, sells it in the ordinary course of business and pays the proceeds over to the consignor without knowledge or information of a claim adverse to that of the consignor, he is not liable, as for a conversion, to one holding a recorded mortgage on the tobacco. Both parties filed motions for summary judgment and the court gave judgment for the plaintiff for the amount claimed. *United States v. Covington Independent Tobacco Warehouse Company,* 152 F. Supp. 612 (E.D. Ky. 1957).

The court in ruling as it did properly concluded that Kentucky law should be binding upon it in this case.[2] But the court went on to conclude that it should not apply the rule of the *Abernathy* case to the facts before it. Instead it chose to apply the generally accepted rule that a factor or commission merchant who receives property from his principal, sells it under the principal's instructions and pays to him the proceeds of the sale is guilty of conversion if the principal had no right to sell the property; and cannot escape liability to the true owner by claiming to have acted in good faith in ignorance of the principal's lack of clear title.[3] For rejecting the *Abernathy* case the court gave three reasons: (1) The rule contravenes certain gen-

[1] 92 Ky. 320, 17 S.W. 858 (1891).
[2] Guaranty Trust Co. v. York, 326 U.S. 99 (1945).
[3] 22 Am. Jur., "Factors", sec. 48 (1939).

erally accepted principles of law in force in this jurisdiction (i. e., the rule set out immediately above). (2) Changes in the tobacco trade and in communication and transportation facilities make the rule no longer desirable. (3) The Kentucky Legislature overruled the case by enacting Kentucky Revised Statute[4] 382.630.

A moment's reflection will reveal that neither of the first two reasons, nor both combined, could possibly justify a Federal Court's refusal to apply, to the facts before it a decision by the highest court of the state in which it sits. The Kentucky court, in deciding the *Abernathy* case took into consideration the generally accepted rule mentioned in the present case and determined that tobacco warehousemen should be excepted from the operation of that rule in certain circumstances. It clearly based its decision on its conception of what would be in the interest of the tobacco trade and commercial life in general and affirmed that decision subsequently.[5] Thus the present court should have followed that case unless the third reason, the conclusion that it was overruled by the enactment of KRS 382.630, is correct. It is upon this latter conclusion that the validity of the decision must ultimately rest.

This conclusion, so necessary to the court's holding, was reached by first stating that the *Abernathy* case was in reality a construction of Kentucky General Statute, 1887, ch. 24, sec. 10,[6] which provided:

> No deed of trust or mortgage, conveying a legal or equitable title to real or personal estate, shall be valid against a purchaser for a valuable consideration, without notice thereof, or against creditors, until such deed shall be acknowledged or proved according to law, and lodged for record.

The court then went on to state that the statute became inadequate and needed an addition to conform to modern times and that the Kentucky Legislature, acting in the light of the court's decision in the *Abernathy* case and for the purpose of changing the law, enacted[7] what is now KRS 382.630 which provides:

> Priority of mortgage lien. The lien of any chattel mortgage which has been lawfully executed and filed for record shall be entitled to priority in all respects over any unrecorded conditional sales contract or any mortgage, lien or encumbrance which has not been filed with the proper recording officer, and shall be valid and effective in all respects against the mortgagor, existing or subsequent creditors of the mortgagor, and any and all third persons.

[4] Hereafter referred to as KRS.
[5] Sidwell v. Cincinnati Leaf Tobacco Warehouse Co., 23 K.L.R. 1501, 65 S.W. 436 (1901); Fields v. Blane, 18 K.L.R. 675, 37 S.W. 850 (1896).
[6] Hereafter referred to as sec. 10.
[7] Ky. Acts, 1934, ex. ses., ch. 1, sec. 3.

That the legislature, when it enacted KRS 382.630, was attempting to legislate in the light of that earlier decision certainly tests one's credulity when it is considered that this section was part of an overall codification of chattel mortgage law, that the case in question was over forty years old at the time of the enactment, and that Sec. 10, supposedly the basis of that decision, was not abolished by the new act but continues to exist, having been carried forward by the revisors into KRS 383.270. Furthermore, during the forty-three years which transpired between the *Abernathy* case and the new enactment, the legislature twice approved the court's construction, if any, of the older statute. The first such approval which came at a legislative session commencing later in the same year of the *Abernathy* decision, was in the form of a total re-enactment of Sec. 10 in conjunction with other sections.[8] Then in 1916 the legislature made detailed revision within Sec. 10, considering that section separately and individually.[9] Significantly, the only changes which were made consisted of inserting the words "or mortgage" after "such deed" and before "shall be acknowledged" and adding a definition of "creditors." This was an even more obvious approval of whatever construction the courts had placed on that statute (which has not yet been repealed). Thus, if the *Abernathy* case was a construction of that section, how can it be said that it was to overrule such construction that the Legislature enacted KRS 382.630 forty-three years later, when in fact it had twice approved the construction at a time when the case was more recent, the issue more alive?

Further evidence of the fact that the Legislature was not legislating in the light of the *Abernathy* case, nor any case for that matter, is the statement which the Legislature appended as Sec. 19 of the enactment[10] and which declared an emergency to exist and made the statute effective immediately upon its passage and approval by the Governor. The emergency thus declared to exist was the evil sought to be remedied.

The emergency was two-fold. In 1934, Kentucky, along with the rest of the country, found itself in the midst of a serious economic depression. Money was scarce and frequently the farmer could obtain money to plant next year's crops only by borrowing it and giving security therefor. But what security could he give if his farm and other property were already mortgaged to the limit as was the usual case? The most obvious security for money borrowed to enable the

[8] Ky. Acts, 1891-1893, ch. 186, sec. 7, p. 829.
[9] Ky. Acts, 1916, ch. 41, p. 434.
[10] Note 7, supra.

borrower to produce a crop would be the crop itself or whatever machinery and equipment the borrower intended to purchase as an aid to the production of such crops. But here the farmer and money-lender were frustrated by the second phase of the problem. A mortgage of after-acquired property, including crops not yet in existence, was void.[11] The only security afforded to the mortgagee by such instruments was that once the property had come into existence or into the hands of the mortgagor, the mortgagee might go into equity and enforce it as a contract to assign the property, provided other rights had not intervened. Beyond this it had no effect at all.[12] Obviously the governmental agencies established to assist the farmer could not advance money on such inadequate security.

It was in response to these inadequacies that the legislature professes to have enacted KRS 382.600-990. The intention was to make mortgages of future crops and other after-acquired property valid and to provide a uniform system of recordation,[13] thereby giving the farmer new security upon which to borrow money. It removed the necessity of the mortgagee's having to rush into equity and get the first decree after the property came into existence in order to have priority over later purchasers, mortgagees, creditors, assignees, administrators or executors, or other third persons who might make some claim to the property which claim formerly would have superseded the rights of the mortgagee of after-acquired property. This new statute put mortgages of after-acquired property on an equal footing with other chattel mortgages and made the federal agencies more willing to accept them as security. This is what was intended. It was not necessary to the accomplishment of this end that the rule of the *Abernathy* case be overruled. That rule had not hampered the security value of mortgages on existing property to which it had always applied with equal force. The legislature set out its purpose very clearly, and the destruction of the court-created exception to the ordinary common law rules of conversion was not one of those purposes.

Admittedly KRS 383.630 as it now stands does state that "The lien of any chattel mortgage which has been lawfully executed and filed for record . . . shall be valid and effective in all respects against . . . *any and all third persons.*" But no one would seriously contend

[11] Cheatham v. Tennell's Assignee, 170 Ky. 429, 186 S.W. 128 (1916); Ross v. Wilson, 70 Ky. 29 (1869); see also: 35 Ky. L.J. 320, 324 et. seq.

[12] Ross v. Wilson, 70 Ky. 29 (1869).

[13] The enactment also provided for procedures for executing, recording and foreclosing upon chattel mortgages and for a new and separate system of maintaining records in this regard. Before this there appears to have been no separate or well-defined procedure provided, and this added to the mortgagee's insecurity.

that the recorded mortgage would be valid and effective as a defense against a vendee of mortgaged property who sued his vendor for breach of warranty of clear title. Who would argue that it would be effective against a storage warehouseman who redelivered mortgagee's property to the mortgagor after default if the mortgagor was the one who stored it? And are we to assume that a common carrier is to be liable for conversion if he accepts for shipment property on which there is a mortgage in default and who has no knowledge of it until after delivery to its destination?[14] Clearly the statute cannot be interpreted so literally. The above are all clearly understood exceptions to the most stringent recording statute. There is another and equally well-established exception to the usual rule in Kentucky as in Missouri,[15] Montana,[16] Oklahoma,[17] Tennessee,[18] some federal jurisdictions[19] and possibly some other jurisdictions. That exception is that a factor or commission merchant, who is in the nature of a public utility[20] or public servant required to serve all who seek his services,[21] and who in the ordinary course of business and in good faith sells goods consigned to him and accounts to the consignor for the proceeds, will not be liable in conversion to the owner of an outstanding claim or interest in the goods. Kentucky has even limited this exception more severely than many other states for here the exception does not apply where the consignor had no right to possession but was a thief.[22]

The rule in Kentucky as established by the *Abernathy* case is a good rule. It is sometimes based upon the fact that the recording statute does not have any effect as against a person who claims no right or interest in the property. It is frequently justified on the grounds that the public commission agent, as opposed to more personal or private agents, cannot choose whom he will serve but must serve all without discrimination. It would be unjust to require him

[14] Shellnut v. Central Ry. of Ga., 131 Ga. 404, 62 S.E. 294 (1908); Nanson v. Jacob, 93 Mo. 331, 6 S.W. 246 (1887).

[15] Cresswell v. Leftridge, 194 S.W. 2d 48 (Mo. App. 1946); Blackwell v. Laird, 236 Mo. App. 1217, 163 S.W. 2d 91 (1942) (citing Abernathy case).

[16] Montana Meat Co. of Helena v. Missoula Livestock Auction Co., 125 Mont. 66, 230 P. 2d 955 (1951).

[17] Kent v. Wright, 198 Okla. 103, 175 P 2d 802 (1946).

[18] Fargason v. Ball, 28 Tenn. 137, 159 S.W. 221 (1913); Frizzell v. Rundle, 88 Tenn. 396, 12 S.W. 918 (1890); Roach v. Turk, 9 Heisk. (Tenn.) 708, 24 Am. Rep. 310 (1871).

[19] Drovers' Cattle Loan and Investment Co. v. Rice, 10 F. 2d 510 (N.D. Iowa 1926); Sullivan Co. v. Wells, 89 F. Supp. 317 (Neb. 1950).

[20] Tagg Bros. & Moorhead v. United States, 280 U.S. 420 (1930).

[21] KRS 248.350.

[22] Irvin v. Phelps, 20 Ky. 242, 45 S.W. 659 (1898). Compare Kent v. Wright, 198 Okla. 103, 175 P. 2d 802 (1946); Blackwell v. Laird, 236 Mo. App. 1217, 163 S.W. 2d 91 (1942).

to serve all and still require him to serve at his risk. Some courts have based their adherence to this rule on the fact that, like a public carrier, he is a mere conduit, not asserting any right. Others say that he is excused because it would not be in the interest of the trade and the steady flow of commerce to burden the warehouseman or commission merchant with the duty of carefully checking the title of each and every consignor, and additionally, force him to bear the risk that the consignor will state his true name and address which would be necessary to such a check. Any one of these or all together would be adequate justification of the rule of the *Abernathy* case. It is a good rule, and it is still the law in Kentucky. Judge H. Church Ford recognized this in a case which came before him on the Frankfort Docket, U. S. District Court, Eastern District of Kentucky as recently as Feb. 1, 1954. In that case[23] the facts were basically the same as in the principal case. The defendant warehouse company filed a motion to dismiss for failure to state a claim and in that motion relied solely on the *Abernathy* case. The court, considering the brief sustained the motion and dismissed the case as to the warehouse company.

It must be concluded from this evidence that the court in the principal case failed to follow the law of Kentucky due to a misconception as to what that law was. It would be desirable if the *Abernathy* case were reaffirmed to preserve a well-reasoned and just exception to the harsh rule of liability which was established when all agents and factors selected whom they would serve and when the relationship was purely personal, not public. The exception would do no violence to the present recording statute.

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PLEADINGS—KENTUCKY RULES OF CIVIL PROCEDURE—RULE 8.01—DOES PLEADING AN EXPRESS CONTRACT PERMIT RECOVERY UPON AN IMPLIED CONTRACT?—The plaintiff brought an action to recover on an oral contract for services performed for decedent. The complaint alleged that the decedent promised "to pay to her or to will or convey to her" certain real property in consideration of personal services rendered by the plaintiff to the decedent. The complaint set out in detail the nature of the services rendered, the circumstances surrounding the agreement, and the plaintiff's performance. There was a demand for a judgment of $6,500, the alleged reasonable value of the land. The

[23] U.S. v. Tilley, Tilley, and Kentuckiana Tobacco Warehouse Co., Civ. Action 117, Frankfort Docket, Feb. 1, 1954.