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Conditional Sales in Kentucky

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Although instruments of credit have long been in use, the demand for them has been very greatly intensified in recent years. High-pressure salesmanship to dispose of goods turned out under modern methods of mass-production, necessitates the granting of time to the buyer to make his payments. This demand for an instrument that will allow the buyer to pay for his purchase at his convenience and at the same time secure the seller, has been met by the use of either chattel mortgages, conditional sales, or trust receipts. These have developed in point of time in the order named. The chattel mortgage is a product of the equity courts. Under a chattel mortgage title passes to the purchaser, and he in turn gives a mortgage back to the seller. The conditional sale is a development of the law courts. The seller retains title to the article sold until the buyer has fully paid the purchase price. In the case of default in the payment of any installment of the purchase price, the seller has the right to repossess himself of the chattel. The law courts have simply carried out the intention of the parties and have failed to see that the object of the transaction is exactly the same as that in the case of the chattel mortgage, to secure the seller until he is fully paid. They have followed the legal view that title is where the parties intend it to be and have overlooked the equitable nature of the agreement. The seller has retained title and he is therefore the legal owner of the thing sold. In the case of the trust receipt the manufacturer or seller forwards the goods to the buyer under an order bill of lading. He then takes this bill of lading to his bank and secures his money or credit for the

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amount of the invoice. The bank attaches a draft for the amount to the bill of lading and forwards it to a correspondent bank. This latter bank notifies the buyer that it has the draft and bill of lading and that he can get the goods by paying the amount of the draft. If he does not have sufficient money to take up the draft and his credit is not good for the amount, the bank may give him possession of the goods by turning over to him the bill of lading and he may give back what is known as a trust receipt. By this agreement he consents to hold the legal title to the goods for the benefit of the bank and to account to it for the proceeds he may derive from the sale of them. He is made a trustee of the goods for the benefit of the bank which has advanced the money to pay the seller for them. Here we have a transaction that has both a legal and an equitable side to it. The law court regards the buyer as the owner of the goods and equity makes him hold them for the benefit of the bank. The trust receipt owes its origin to the foreign import business. It was found to be a highly satisfactory method of carrying on business between parties who lived at a great distance from each other. In recent years its use has been increasing in domestic trade.

The typical trust receipt transaction involves three parties, a seller, a buyer and a bank. Here, too, the seller is simply securing the purchase price. He is protecting himself against the buyer’s inability to pay for the goods. This method of securing a debt has proved so convenient that many have sought to make use of it in the case of an ordinary loan. One owning goods has applied for a loan and to secure the loan has given the lender a trust agreement under which he has stipulated to hold the goods in trust for the lender. They have here tried to turn what is ordinarily a three party arrangement into a two party affair. Most courts are quick to discover these attempts to get the benefits of a chattel mortgage under the form of a trust receipt and will hold them bad unless compliance has been had with the recording requirements.¹

In addition to chattel mortgages, conditional sales agreements and trust receipt transactions there are other arrangements between vendors and vendees which courts are called upon

to distinguish. The court may find that the particular transaction under consideration is merely a contract for a sale, in which case the prospective seller's claim to the chattel prevails over the rights of third parties.\(^2\) There is also the case where goods having been obtained for distribution, handling, and storing under an agency contract, the transaction has been deemed a bailment and not a sale.\(^3\)

Chattel mortgages today, to be good against bona fide purchasers and creditors, must be recorded. This is true in Kentucky.\(^4\) They are not valid against one who purchases for value and without notice.\(^5\) Unrecorded chattel mortgages, however, have always been held valid between the parties and those taking the property with notice of the mortgage.\(^6\)

In the earlier cases dealing with conditional sales the Kentucky Court of Appeals upheld their validity in transactions between the original parties,\(^7\) and in some cases it sought to distinguish between chattel mortgages and conditional sales.\(^8\) The court finally accepted the equitable view of them and it became the settled policy of the court to treat them as chattel mortgages when the rights of third persons were involved.\(^9\) As early as 1873 we find the court giving its reason for holding such sales contracts bad against a bona fide purchaser from the conditional vendee. In the case of \textit{Vaughn v. Hopson}\(^10\) a mule was sold under a stipulation that it was "bound or the title of the mule remains in Hopson (the vendor) until he gets his money." The court said in giving its opinion: "In this case the only evidence of the vendor's lien is to be found in his own pocket; and after

\(^{2}\) Hill v. Mudd, 9 Ky. L. Rep. 59 (1887).
\(^{3}\) Refiners Oil Corporation v. Bell, 263 Ky. 216, 92 S. W. (2d) 88 (1938).
\(^{4}\) Carroll's Ky. Stat. Sec. 496.
\(^{5}\) Payne v. Farr, 8 Ky. Opin. 179 (1874); Greer v. Church, 76 Ky. (13 Bush) 430 (1877); Townsend v. Frazer, 21 Ky. L. Rep. 1183, 54 S. W. 722 (1900); General Motors Acceptance Corp. v. Wigger, 249 Ky. 722, 61 S. W. (2d) 620 (1935).
\(^{7}\) Prather v. Norfleet, 8 Ky. (1 A. K. Marsh.) 178 (1818); Patton v. McCane, 54 Ky. (15 B. Mon.) 555 (1855).
\(^{8}\) Price v. Bearden, 8 Ky. (1 A. K. Marsh.) 169 (1817).
\(^{9}\) Tucker v. Witherbee, 130 Ky. 289, 113 S. W. 123 (1908); Morrow Mfg. Co. v. Race Creek Coal Co., 222 Ky. 807, 2 S. W. (2d) 662 (1928).
\(^{10}\) 73 Ky. (10 Bush) 337 (1873).
placing the property in the possession of his vendee, and making him at least the ostensible owner, he should not be allowed to make others trust this vendee when not willing to do so himself."

The court added that to enforce the agreement against the innocent purchaser from the vendee would be to place such purchaser at the mercy of the vendor since, in a way, the vendor had invited him to make such purchase. As far as third persons are concerned, then, the Court of Appeals in Kentucky does not recognize conditional sales as such. It construes the contract as passing title to the purchaser with a lien in favor of the seller for the unpaid purchase price, which lien may be enforced between the parties. That is, it treats the transaction as a chattel mortgage and within the terms of the recording act.

In cases where the intention of the parties has not been made clear in their contract as to whether the agreement was a chattel mortgage or a conditional sale transaction, the court has always taken the equitable view of the agreement and treated it as a mortgage. Since this doctrine of treating a conditional sales contract as a chattel mortgage is derived from equity, as already suggested, it will not be applied when there is a good equitable reason for not so doing, as, for instance, where the parties are guilty of laches.

It also follows from taking the equitable view that since the vendor stands in the position of a mortgagee, upon default he is entitled to the absolute right to possession of the mortgaged property. Of course where the instrument is recorded as a chattel mortgage, a purchaser from the vendee cannot raise the question that the transaction was really intended

11 Fry Bros. v. Theobold, 205 Ky. 146, 265 S. W. 498 (1924).
13 Tygret v. Porter, 97 Ky. 54, 28 S. W. 976 (1895); Welch v. National Cash Register Co., 103 Ky. 30, 44 S. W. 124 (1898); Wender Blue Gem Coal Co. v. Louisville Property Co., 137 Ky. 339, 125 S. W. 732 (1910).
15 Warren v. Lamb, 7 Ky. L. Rep. 682 (1886); White Sewing Machine Co. v. Conner, 111 Ky. 827, 64 S. W. 841 (1901); Hawkins Furniture Co. v. Morris, 143 Ky. 738, 137 S. W. 527 (1911); Montenegro-Rishm Music Co. v. Bueris, 160 Ky. 557, 169 S. W. 986 (1914).
as a conditional sale.\textsuperscript{16} It also follows from the view the court takes of conditional sales contracts that if they are to be regarded as mortgages they must be enforced by action on default in payment, although formerly they were enforceable according to their terms.\textsuperscript{17} The court pointed out in the \textit{Hawkins Furniture Company} case that the vendor or mortgagee must not commit a breach of the peace in taking possession and that he must hold the property subject to the rules applicable to mortgagees in possession and that within a reasonable time, if the vendee did not redeem, dispose of the property at a fair sale and on adequate notice, returning to the vendee any surplus above the amount of the unpaid purchase price. So where an automobile was repossessed on default in payment of an installment, it was held a conversion on the vendor's part not to sell within a reasonable time and turn over the balance above the unpaid purchase price.\textsuperscript{18}

With the adoption of the Uniform Sales Act in 1928 the court's attitude as to conditional sales contracts changed. The retention of title provision was no longer treated as void and the whole transaction as merely creating a lien in favor of the vendor. In \textit{General Motors Acceptance Corporation v. Shuey}\textsuperscript{19} the court observed: "Conditional sales contracts expressly reserving title in the seller are recognized by law, and under such contracts, title does not pass to the purchaser until he has completed and performed the contractual stipulation therein."

\ldots "Prior to the enactment of the Uniform Sales Act in 1928 (Ky. Stat., Sec. 2651b-1 et seq.) this court has consistently held a conditional sales contract to be, in effect, a chattel mortgage." The court further stipulated that provisions in such contracts for acceleration of maturity of future installments in the event of default, may not be condemned as oppressive. The court, however, in a later case held that if the title is retained as security for the price and the vendee's obligation to pay the balance was not abated by the vendor's retaking possession and

\textsuperscript{17}Singer Sewing Machine Co. v. Dyer, 156 Ky. 156, 160 S. W. 917 (1913).
\textsuperscript{18}Commercial Credit Co. v. Cooper, 246 Ky. 513, 55 S. W. (2d) 381 (1932).
\textsuperscript{19}243 Ky. 74, at 77, 47 S. W. (2d) 968, at 970 (1932). See also General Motors Acceptance Corp. v. Dickinson, 249 Ky. 422, 60 S. W. (2d) 967 (1935).
retaining the installments already paid, the transaction was not to be regarded as a conditional sale but as an undertaking in the nature of a chattel mortgage.\textsuperscript{20} Recordation of a conditional sales contract since the adoption of the Uniform Sales Act is still regarded as constructive notice to a purchaser from the vendee and the retention of the chattel after demand from the vendor or his assignee is a conversion.\textsuperscript{21} On the whole, the passage of the uniform act has really made very little change in the court's treatment of conditional sales contracts aside from the court's regarding them as what they purport to be and not as chattel mortgages. They still require that they be recorded to be effective against innocent purchasers.\textsuperscript{22} It will require the adoption of the companion act to the Uniform Sales Act, the Uniform Conditional Sales Act, in this state to effect any very material change.

It not infrequently happens that an automobile or other chattel is sold under a conditional sales agreement in one state and then later it is taken into another state and there resold to one not having notice of the term under which his vendor secured his possession. For instance, an automobile may be acquired in Tennessee under a conditional sale agreement and brought by the conditional purchaser into Kentucky and there resold without disclosing the nature of his possession. It may be that there is a recording act covering such transactions in the state where the sale occurred and that its provisions have been complied with by the vendor. Where the conditional sale is valid in the state where it was made, the Kentucky Court of Appeals has held that there is no settled public policy in this Commonwealth against giving effect to such contracts and it holds them good even against an innocent purchaser for value.\textsuperscript{23} However, where the sale was made with the understanding that the chattel was to be taken into Kentucky the court has held otherwise. In John-


\textsuperscript{23} Fry Bros. v. Theobold, supra n. 11; Tennessee Auto Corp. v. American National Bank, 205 Ky. 541, 266 S. W. 54 (1924); Shelter's Garage v. Walton, 212 Ky. 602, 279 S. W. 959 (1926); Kelly v. Brack, 214 Ky. 9, 282 S. W. 190 (1926).
son v. Sauerman Bros., Inc. machinery was sold in Illinois for the purpose of building a levee in the state of Kentucky and the vendor so understood. He recorded his conditional sales agreement in Illinois but not in Kentucky. The Kentucky court allowed judgment creditors to attach and levy upon the machinery as property of the conditional vendee, and in an early case dealing with a similar situation the court went so far as to say that property bought in another state and brought into this state would be governed by the law prevailing here. The conditional sales contract in that case was not recorded and it was held that no lien was created which was good against innocent purchasers and creditors.

Many cases have arisen between purchasers at an execution sale, where the chattel has been levied upon as the property of the vendee, and the conditional vendor. At execution sales the rule of *caveat emptor* applies, and, if the buyer receives notice at the time of the sale that the property was held by the judgment debtor under an unrecorded conditional sale agreement, the vendor is allowed to prevail.

There are also cases relative to conditional sales in addition to those already considered which, perhaps, turn not so much upon principles relative to such sales contracts as upon the particular facts involved. In *Commonwealth v. Larson*, for instance, the defendant seized an automobile under the terms of an agreement whereby title was reserved in the seller until the price was paid and whereby the seller was allowed to repossess himself of the car upon default. The seller did repossess himself of the car upon default and was prosecuted under a statute that made it a misdemeanor to take possession of the property of another. It was held that he was justified in taking the car but was held under the statute for taking a package of laundry that was in the car when he took it and which he did not discover and return until four days had elapsed. In *Kugler v. Rouss* a stock of goods was purchased at a sheriff’s sale and the pur-

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24 *Supra* note 22.
27 242 Ky. 317, 46 S. W. (2d) 82 (1932).
28 23 Ky. L. Rep. 972, 64 S. W. 627 (1901).
chaser employed the execution debtor to hold the goods as his agent and to continue the business. The buyer agreed to transfer the goods to the agent when the indebtedness to the former should be paid out of the proceeds of the business. The agent also agreed to turn over the goods and to account to the buyer upon the latter’s demand. He refused to do either when demand was made upon him. The court found that the transaction was not a conditional sale and that the agent could not defeat the buyer’s right to the goods by abandoning the scheme contemplated by the clause in the agreement. And in Mitchell v. Jeff Davis Motor Company a truck sold plaintiff by the defendant was demanded of the former upon default in the payment of two installments of the purchase price. The contract provided that the seller might repossess himself of the truck upon default. By agreement the truck was delivered into the hands of a third party to be redelivered to the vendor if the amounts in arrears were not paid by a certain time. They were not so paid and the truck was delivered to the vendor. The plaintiff vendee thereupon sued claiming fraud. The court ruled that the vendor was not obliged to file the conditional sales contract as evidence in the case and since fraud was not shown to have been employed in securing the surrender of the truck, judgment was given the defendant vendor.

To recapitulate, as the cases stand today, an unrecorded conditional sales contract does not bind the purchaser for value from the conditional vendee where he has no notice that the vendee is holding the property under such a contract. This very naturally raises the question as to when such a buyer has notice and what constitutes notice. It is well settled in the law that a person who does not have actual notice may, nevertheless, be charged with notice; that is he may have constructive notice. Where the law requires a document to be recorded with the register of deeds or with the clerk of the county court and such document is so recorded, a purchaser is charged with notice although he does not have actual knowledge that there is such a document or that it is recorded. It should be the same where there is a well-defined business practice, and a person knows or should know of such practice. Such apparently was the rule as to factors and goldsmiths as early as the days of Lord Mansfield.

At least we find a dictum to that effect by him in *Mace v. Cadell*\(^30\) where in speaking of the statute of fraudulent conveyances he said: "At the same time, the statute does not extend to all possible cases, where one man has another man's goods in his possession. It does not extend to the case of factors or goldsmiths, who have the possession of other men's goods merely as trustees, or under a bare authority, to sell for the use of their principal; but the goods must be such as the party suffers the trader to sell as his own." Persons dealing with factors and goldsmiths were charged with knowledge that goods had been intrusted to their possession by the true owners and were not to be dealt with on the basis that they belonged to the factors or goldsmiths. There is something of this nature in the law of contracts. Where there is a well established practice or custom of a trade or business and a contract is made with that custom or practice in view, evidence as to it will be admitted to show the intention of the parties. That is, it is really a part of the contract.\(^31\) Today, in Kentucky, the retail marketing of automobiles, electric refrigerators, and the like, is very largely done by means of conditional sales agreements. It is possible that such agreements cover eighty per cent of the total sales made. For the country as a whole about sixty per cent of all new automobiles are sold on installments and between eighty and ninety per cent of all electric refrigerators and electric household equipment are sold on credit. The importance of the subject may be realized when we consider that it is estimated that the three largest commercial credit companies will do a business of over three billion dollars this year.\(^32\) Owing to the expense and inconvenience of complying with the recording act a great many dealers never record such agreements unless they deem particular risks doubtful. This practice of not recording such agreements, although possibly not so universal today as formerly, may be said to show a business need of a method of handling these transactions without the necessity of recordation. After all, it is sometimes said that the law should follow business practice. Law does not exist as an end in itself as many seem to think. Furthermore, in this particular instance since the statute does not expressly apply to


\(^{31}\) See Williston on Contracts, Sections 651–654.

\(^{32}\) Richmond: *Accelerating Business Credit*, Magazine of Wall Street, September 26, 1936, p. 702.
conditional sales,\textsuperscript{33} might it not be fairly argued that one who buys an automobile should be put on inquiry as to his vendor's title? Should he not be charged with notice of a business custom of marketing automobiles by conditional sales transactions? Such a position on the part of the court would not call for a radical change in its holdings in such cases. The purchaser would be found not to be a \textit{bona fide} purchaser and would be bound by the conditional sale. Probably greater justice would be done by such a course as a great part of the cases arising under the recording act are cases of attaching creditors of the vendee. It is hard to see how such creditors are to be preferred over the claims of the conditional vendor.

\textsuperscript{33} Ky. Stat. Sec. 496.