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EXTRATERRITORIALITY OF A CHATTEL SECURITY INTEREST: A PLEA FOR THE BONA FIDE PURCHASER

*JESSE S. RAPHAEL**

INTRODUCTION

CHATTEL security is big business. Installment sales of durable goods to consumers in the United States involved an outstanding credit, as of September 1959, of over thirty-seven billion dollars. Of this outstanding credit over sixteen billion dollars concerned time-payment sales of automobiles.[1] Almost all, if not all, of this credit, was expressed legally in the form of "time paper," that is, of installment contracts—usually conditional sales agreements or chattel mortgages—in which the creditor is given a security interest in the chattel sold as a means of obtaining payment in the event the consumer-debtor fails to pay.

The security contract contemplates that the subject chattel will be more or less in use and at rest in the state in which the debtor-buyer resides or has his place of business. The security contract ordinarily provides that the chattel is not to be moved from that place without the knowledge and consent of the secured party.

But people and their possessions do not stay put. State borders offer no barriers to movement. Modern facilities for quick transportation from state to state, the exigencies of business and of life encourage frequent interstate movement. In addition, agencies for the rapid disposal of used chattels are widespread. Dealers in used automobiles are an especially familiar phenomenon in every locality. Suppose, therefore, a buyer of a chattel subject to a security interest moves the chattel, with or without the consent of the secured party, to another state and there disposes of it in the ordinary channels of used goods trade. How should modern courts adjust the conflicting claims of the secured party and the subpurchaser?

Stated in legal terms, the problem concerns the conflict in the claim, on the one hand, of a creditor who has by contract acquired a security interest in the chattel in one state (which for convenience will be hereinafter termed the Contract State), and the claim, on the other hand, of a bona fide purchaser for value of that chattel who has bought it in another state (hereinafter for convenience called the Removal State), to which the chattel has been removed by the debtor with or without the consent or knowledge of the "secured" creditor. The problem confronts the forum

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1. N.Y. Times, Oct. 31, 1959, p. 29, col. 6.

in which the chattel is presently located and in which the parties seek relief. That forum may be either in the Removal State or in a third state in which the chattel comes to rest while the "secured" party or his successor in interest, and the bona fide purchaser, or his successors in interest, litigate their claims, each asking that his claim prevail over the other.

Our discussion will involve consideration of the manner in which the problem has actually been disposed of by the courts of the various states, either pursuant to case law or statute, or the so-called rules of the conflict of laws; the various theories underlying the decisions of the fori; the principles which the author believes should have been applied; and some suggestions as to how the problem may be finally laid to rest with justice and fairness to both parties.

To avoid repetition, unless the context shows otherwise, the term "debtor," when used in this discussion, will signify the person who owes performance of the obligation secured and who has every proprietary right in the chattel, which is the subject matter of the security, except those rights which are possessed by the creditor under the security agreement. The term "secured party" will mean a party who advances credit and by contract with the debtor in the Contract State obtains a security interest in a chattel which, under the laws of the Contract State, he perfects as against bona fide purchasers from the debtor, the chattel remaining in the possession of the debtor. The term "bona fide subpurchaser" will mean a party who, for value and without notice or knowledge of the secured party's interest, buys the chattel from the debtor in the Removal State to which the debtor has brought the chattel, with or without the consent of the secured party.

An examination of the cases, with regard merely to the outcome of the litigation, reveals that they fall into three classifications.[2] In an overwhelming majority of the fori, the secured party prevails over the bona fide subpurchaser if the chattel was removed from the Contract State without the knowledge or consent of the secured party.[3] If, however, the secured party knew of the removal at the time it took place, or it was intended under the original security agreement that the chattel would be removed, the majority of the courts hold that the secured party will not prevail, unless he perfects his security interest in the Removal State as against bona fide subpurchasers by whatever procedures are required by

2. Stumberg, Chattel Security Transactions and the Conflict of Laws, 27 Iowa L. Rev. 528, 537 (1942).

3. See, e.g., Denkins Motor Co. v. Humphreys, 310 Ky. 344, 220 S.W.2d 847 (1949); Memphis Bank & Trust Co. v. West, 260 S.W.2d 866 (Mo. App. 1953). See also Cleveland Mach. Works v. Lang, 67 N.H. 348, 31 Atl. 20 (1893).

the local laws of the Removal State.[4] There are, however, a few courts which hold that the bona fide subpurchaser prevails, whether or not the secured party has knowledge of, or consents to, the removal of the chattel to the Removal State.[5]

In almost all of the cases where there is judicial discussion of the reasons for granting judgment in favor of the secured party, it is stated that the courts feel obliged, despite their own local laws, to apply the law of the state wherein it is determined that the secured party has obtained his security interest, in accordance with the principle of comity. But in determining the basis for the adoption of the outside law, different theories are enunciated.

Various Applications of the Principle of Comity

Some courts base their decision on what, for convenience, shall be called the *Contract Theory*.[6] A typical case following this theory is *Studebaker Bros. Co. v. Mau*.[7] Here, the plaintiff, on May 2, 1903, sold a buggy and accessories to Secrist and Mahan on a conditional sale. The contract of sale was made and the chattels delivered in Salt Lake City, Utah, where the plaintiff had its place of business and Secrist and Mahan resided. Some time thereafter, without the knowledge and consent of the conditional vendor, the chattels were removed by Mahan to Wyoming and there sold to defendant Mau on September 12, 1903, for cash. Mau had no knowledge or notice of plaintiff's claim, and did not know that the property had been removed from Utah until just before the action was commenced. Plaintiff sued in the Wyoming court to recover possession of the buggy. The laws of Utah required chattel mortgages to be filed with the county clerk in order to be valid as against bona fide purchasers but conditional sales were valid as against such purchasers without recording. In Wyoming at this time, however, conditional sales

4. Hervey v. Rhode Island Locomotive Works, 93 U.S. 664 (1876); Robbins v. Bostonian, 138 F.2d 622 (8th Cir. 1943); Summers v. Carbondale Mach. Co., 116 Ark. 246, 173 S.W. 194 (1915).

5. See, e.g., Turnbull v. Cole, 70 Colo. 364, 201 Pac. 887 (1921); Judy v. Evans, 109 Ill. App. 154 (1903); Delop & Co. v. Windsor & Randolph, 26 La. Ann. 185 (1874); Boydson v. Goodrich, 49 Mich. 65, 12 N.W. 913 (1882); Bank v. Carr, 15 Pa. Super. 346 (1900); Consolidated Garage Co. v. Chambers, 111 Tex. 293, 231 S.W. 1072 (1921); Farmer v. Evans, 111 Tex. 283, 233 S.W. 101 (Civ. App. 1921); Union Sec. Co. v. Adams, 33 Wyo. 45, 236 Pac. 513 (1925).

6. Stumberg, Conflict of Laws, 399-400 (2d ed. 1951), citing Gross v. Jordan, 83 Me. 380, 22 Atl. 250 (1891): "The tendency of the cases has been to deal with problems of title arising between the seller and buyer as involving questions of contracts." See also Thomas G. Jewett, Jr., Inc. v. Keystone Driller Co., 282 Mass. 469, 185 N.E. 369 (1933).

7. 13 Wyo. 358, 80 Pac. 151 (1905).

were void, as against bona fide purchasers, unless the original or a copy of the contract was filed in the office of the county where the property was located.

The Wyoming court, allowing the outstate secured party to prevail, said in part:

> Where . . . a conditional sale of personal property is made in one state between parties residing in that state, and where the property is then situated and delivered, and without any agreement or intention that the property is to be removed to another state . . . and the conditional vendee, without the knowledge or consent of the vendor, removes the property to another state and there sells it to a bona fide purchaser, such purchaser acquires only such rights in the property as the conditional vendee had therein. . . . In such cases the lex loci contractus will govern. The rule is stated in Keenan v. Stimson, 32 Minn. 377, 20 N.W. 364, to be that the validity and effect of contracts relating to personal property are to be determined by the laws of the state or country where they are made, and, as a matter of comity, they will, if valid there, be enforced in another state or country, although not executed or recorded according to the laws of the latter.[8]

To the Wyoming court, the rule of comity apparently meant that by the conditional sales contract made in Utah, certain interests in the chattel were acquired by the conditional vendor, and by the same contract, certain restrictions were placed on the powers of the conditional vendee in dealing with the chattel. When the chattel was removed to Wyoming, without the conditional vendor's consent, the latter's contractual rights in the chattel and the vendee's contractual lack of power of disposition followed the chattel into Wyoming. This should be recognized as such by a court of Wyoming regardless of prevailing Wyoming law, which, had it been applied, would have determined the interests and powers of the conditional vendor and vendee differently.

In reaching its conclusion, the court relied entirely on the rule of conflict of laws as to the proper choice of law in determining the nature, validity and effect of contracts. The application of that rule to a simple, uncomplicated transaction may be logically supported by arguing that the parties in entering into a contract have in mind the laws of the state in which they are contracting. Such laws become a part of the contract as though they had been expressly set forth in its terms. When, therefore, the *same* parties are later in legal conflict in another state in respect of this contract, their contractual intentions are properly and naturally spelled out in terms of the *lex loci contractus*. Even this simple rule is not universally applied and has given rise to much confusion as to the proper application of the rule.[9] For example, the parties may have made

8. Id. at 369, 80 Pac. at 154.

9. Goodrich, Conflict of Laws § 110, at 321 (3d ed. 1949); Stumberg, op. cit. supra note 6, at 227.

their contract en passant, with no regard at all for the laws of the state in which they were contracting. In fact, in many cases, they might have definitely had in mind the laws of the state where the contract was to be performed or, if the contract dealt with property, the laws of the state where the property was located at the time the contract was made, or at the time it was to be performed.[10]

Whatever may be a proper rule as to conflict of laws relating to contracts, is that rule relevant to a solution of the security interest problem we are now discussing? The original parties to the security contract are not in litigation in the Removal State. A stranger to that contract, the subpurchaser, is claiming an interest in the chattel, not derived from the original contract, but created by a new contract made in the Removal State. It cannot be asserted (so as to bring in the *lex loci contractus*) that the bona fide subpurchaser of the chattel had in mind or had any knowledge of the contract creating the security interest in the Contract State, or that he had any knowledge that such a security interest had in fact been created prior to the time of his purchase. Having neither notice nor knowledge of the security interest, the subpurchaser can hardly be claimed to have made his own contract of subpurchase with regard to it or to the original contract which created it.

Indeed, in the litigation in the Removal State between the secured party and the bona fide subpurchaser, the problem is not a contract problem at all, but a question of priority of property interests. Chief Justice Marshall recognized this in *Harrison v. Sterry:*[11]

> The law of the place where a contract is made is, generally speaking, the law of the contract; *i.e.*, it is the law by which the contract is expounded. But the right of priority forms no part of the contract. . . . It is extrinsic, and is rather a personal privilege, dependent on the law of the place where the property lies, and where the court sits which is to decide the cause.

Some of the courts, in declaring that they are governed by the principle of comity, base their decisions on what, for convenience, might be characterized as the *Situs Theory* in conflict of laws as to chattel interests. Most courts in adopting this theory take it to mean that when at the time of the making of the security contract, the chattel has its situs in a given state (usually the same state as the Contract State), rights and interests in the chattel are to be determined by the *lex loci rei,* which the court of the forum should apply. These courts usually recognize that their choice of the *lex loci rei* is not compulsory and that they are free, when their local laws or local public policy is in conflict therewith, to

10. Goodrich, op. cit. supra note 9, at 322-23; Stumberg, op. cit. supra note 6, at 401.
11. 9 U.S. (5 Cranch.) 289, 298 (1809).

ignore the *lex loci rei* and decide the case on the basis of local law and policy.[12]

There are, however, those who maintain that interests created by the security contract are, as soon as created, "vested interests" which no court in any other jurisdiction has the right or power to disturb. Implicit in the vested interest theory is the proposition that an interest in a chattel created by contract in some mysterious way is attached to the chattel and follows it from jurisdiction to jurisdiction. Professor Beale has been, in modern times, the most influential advocate of this vested interest theory.[13] His vigorous advocacy has had a material influence on the final draft of the Restatement of Conflict of Laws,[14] but the theory itself has been as vigorously criticized by other legal writers.[15] If the theory were carried out in practice in court decisions, there would be a strong basis for compelling a Removal State to give "full faith and credit" to the chattel interests created by contract in other states. A denial of such full faith and credit could be attacked as a denial of due process under the Constitution. No decision of the United States Supreme Court has gone this far.[16] A statement of the reasons for rejecting the vested interest theory is to be found in the following quotation, in which the Removal State is called state "Y":

> Despite the lack of direct authority on this point, it is submitted that Y's constitutional jurisdiction in the situation where removal was without the original owner's consent cannot be successfully questioned. Any such attack, whether based on the due process clause or the full faith and credit clause, must show that State Y lacks a legitimate governmental interest in the title to the chattel brought within its borders. The existence of such governmental interest is acknowledged when the chattel is normally present in the state; it is difficult to see why the interest does not exist in like manner when the property is atypically present. Each state has constitutional authority to make its own laws with respect to persons and events within its own borders and any dealing with a chattel in State Y is an event, and remains an event, despite the irregular methods by which the chattel came to be present within the state.[17]

12. Hervey v. Rhode Island Locomotive Works, 93 U.S. 664 (1876).

13. Beale, Jurisdiction Over Title of Absent Owner in A Chattel, 40 Harv. L. Rev. 805 (1927). See also 13 Ill. L. Rev. 43 (1918).

14. Restatement (Second), Conflict of Laws, §§ 265-66, 272-73 (1958).

15. See, e.g., Comment, Validity of Judgments Refusing Recognition To Chattel Mortgages Recorded In Another State, 37 Yale L.J. 966, 968 (1928), citing Dodd, The Power of The Supreme Court To Review State Decisions in the Field of Conflict Of Laws, 39 Harv. L. Rev. 531 (1926). See also Cook, The Logical And Legal Bases Of The Conflict Of Laws, 33 Yale L.J. 457 (1924); Lorenzen, Territoriality, Public Policy And The Conflict Of Laws, 33 Yale L.J. 736 (1924); Yntema, The Horn Book Method And The Conflict Of Laws, 37 Yale L.J. 468 (1928).

16. See supra note 15. The consensus is that the constitutional clauses do not apply.

17. Note, The Power Of A State To Affect Title In A Chattel Atypically Removed To It, 47 Colum. L. Rev. 767, 773 (1947).

The *situs theory* may have validity where the litigation concerns the original parties to the security contract, for the same reasons as have been previously expressed with regard to the *contract theory*.

The essential weakness in the situs and vested interest theories, as applied to our problem, is the semantic twist which *reifies* the legal position of the secured party and fails to ascribe to that position its essential nature, namely, that it is not an *interest* which *attaches* to the chattel, but rather a claim of priority as against other claimants.[18] Such a claim of priority is successful to the extent that a court will give it validity. In the Contract State where the priority claim is initiated by the security contract, the law there may and frequently does require the claimant to *perfect* his claim in that state by such a procedure as public recording.[19] Such a requirement is a recognition of the fact that the security contract itself does not create the priority. It is also a recognition of the fact that the priority is a right *ad personam* and not *attached* to the chattel. When, therefore, the chattel is removed to another state, no priority claims are carried with it, unless the Removal State, now having complete and unrestricted dominion over the chattel located within its borders, voluntarily decides to recognize the outstate priority.

Even though the courts of the Removal State are inclined to favor the *situs theory*, they face the same dilemma as the courts adhering to the *lex loci contractus theory*. At the time the Removal State court is asked to decide between the parties, a second contract has been made and the chattel has a second situs. The security contract is made in reference to the situs of the chattel at the time the contract is executed, but the subpurchaser's contract is made in the Removal State at a time when the chattel has a new situs there. Consistent with the *situs theory*, therefore, the bona fide subpurchaser may rightly maintain that the validity of his contract of subpurchase and the rights it creates should be determined by the new situs of the chattel, no matter whether that new situs was brought about with or without the consent of the outstate secured party.[20]

While the *situs theory*, therefore, like the *contract theory*, may satisfy the ends of justice when the litigation involves the parties to the creation of the original security interest, neither provides a satisfactory guide when a new interest or claim to priority is raised extraterritorially by a stranger to the original transaction.

The court of the Removal State is thus justified in weighing as *res nova* the respective and conflicting claims of the outstate secured party and its own citizen who has in good faith parted with his money in

18. Stumberg, op. cit. supra note 2, at 542.
19. E.g., N.Y. Lien Law, § 230.
20. See Chief Justice Marshall's opinion, p. 423.

the belief that he was purchasing a chattel free of encumbrances. In other words, the court of the forum is and should be free to follow its own concepts of fairness and considerations of social expediency, there being no overriding rule of conflict of laws controlling its decision.

In actual practice, the courts have done just that. Despite broad dicta as to comity, *lex loci contractus* and *lex loci rei*, the courts, in favoring the secured party, have decided the cases in accordance with their own general feeling as to what was fair, just, and socially expedient under the circumstances.[21] Unfortunately, in many cases where the outstate secured party has been upheld, the court's attitude as to social expediency, while not expressly controlled by the rules of conflict of laws, is unconsciously affected by the court's traditional respect for those rules. The remainder of this article will discuss why there are more logical and more compelling factors, both in precedent and in natural justice, for giving judgment to the bona fide subpurchaser.

In taking a de novo view of the subject problem, the court will find support in ancient principles, in new concepts of chattel negotiability, and in the principles of fairness and natural justice, for deciding in favor of the bona fide subpurchaser as against the outstate secured party.

Ancient Statutory and Case Law

Early English statutes and case law demonstrate a general disfavor of secret liens and a recognition of the doctrine of *ostensible ownership* through possession. It is difficult to determine from the cases to what extent these ancient principles were founded on case law and to what extent they stem from the statutes, collectively known as the Fraudulent Conveyances Statutes,[22] which provided that where the grantor remained in possession, after a conveyance of property, the conveyance was fraudulent and void as to creditors of the grantor, and such a conveyance was likewise fraudulent and void as to bona fide purchasers from the grantor.

The early English cases described and treated the chattel mortgage

21. Stumberg, op. cit. supra note 2, at 366: "A majority of the courts feel that preferences should be given the conditional vendor or mortgagees when the chattel is wrongfully removed from the state where it was originally sold and the law there has been complied with, because they think that it is better social policy to protect him against a person who, although he is innocent, is claiming title through a wrongdoer whose wrongful act is beyond the effective control of the vendor or mortgagee. In other words, the point of view of a majority of the courts is that it is better social policy to further the security of credit transactions by protecting, under the circumstances, the holder of the lien." See also 18 N.Y.U.L. Rev. 553, 554 (1941).

22. 13 Eliz. 1, c. 5 (1571); 27 Eliz. 1, c. 4 (1585). See also Glenn, The Chattel Mortgage as a Statutory Security, 25 Va. L. Rev. 316, 324 (1939).

as a "bill of sale to secure a debt."[23] In *Twyne's Case*,[24] dealing with a sale of personal property, the court decided that retention of possession by the vendor after the sale constituted a "badge of fraud" as against creditors of the vendor who, being misled into believing that the vendor owned the property because he was in possession, gave him credit in reliance thereon. A later English case[25] applied the same principle to a transaction involving a chattel mortgage where the mortgagor remained in possession. While the statutes and case law describe the mortgagor's retention of possession as "fraudulent" as to the mortgagor's creditors and bona fide purchasers, the "fraud" consists in the fact that both creditor and purchaser are misled into believing the mortgagor to be the unencumbered owner of the chattel because of his possession. This is still good law in many American jurisdictions. The philosophical principle underlying this attitude is the sound doctrine of ostensible ownership.[26] The subpurchaser from the mortgagor relies in good faith on his seller's having good title, because the mortgagor has what seems to be free and unencumbered control of the chattel. The mortgagee has voluntarily permitted the debtor to have possession, thereby placing it within the debtor's power to sell and deliver the chattel to a bona fide subpurchaser.

Constructive Notice of Ownership

To offset the appearance of ownership through possession, and to afford a means whereby the mortgagee can maintain his priority claim, although possession was granted to the mortgagor, a recording procedure is frequently established by statute for the purpose of giving publicity to the otherwise secret lien.[27] The subpurchaser may thus have no just claim to priority if at the time he makes his purchase he has actual knowledge or notice of the prior outstanding claim of the secured party. A proper constructive notice to the subpurchaser, by a public recording, takes the place of actual knowledge and makes unreasonable the subpurchaser's reliance on possession of the debtor as ostensible ownership.

But the device of recording, as constructive notice, is ineffective when the chattel is removed from one recording jurisdiction to another. It is unrealistic to assume, as some courts have contended, that by publicly registering the security interest contract in the Contract State, the

23. Glenn, supra note 22, at 316.

24. 3 Co. 80b (K.B. 1601).

25. Ryall v. Rowles, 1 Atk. 165 (ch. 1749). The court said: "As to the possession of the goods, I have no other way of coming to the knowledge of the owner but by seeing who is in possession of them . . . ." Id. at 168.

26. Karst v. Gane, 136 N.Y. 316, 32 N.E. 1073 (1893); Glenn, supra note 22.

27. See Glenn, supra note 22, at 326.

secured party has given constructive notice to the world.[28] In the first place, it is generally held that constructive notice is limited only to the classes of persons specifically referred to in the recording act. For example, a recording of a chattel mortgage may, by statute, be constructive notice to a purchaser from the mortgagor. It is not constructive notice, however, to one who deals with a tortfeasor mortgagor, without having actual knowledge of the mortgagee's interest.[29]

No recording act has been found which expressly provides that the constructive notice created by its application shall extend to purchasers outside the state. Indeed, a state recording statute, inasmuch as it is a state statute, must be deemed to affect only those parties within the state of its enactment.

It is obvious that the words *constructive notice* can have no sensible meaning unless they imply that the person constructively notified had it within his power to achieve actual knowledge of the facts by a diligent examination of the pertinent public records.[30] But the bona fide subpurchaser who buys a chattel located in his state, without knowledge that it has been previously removed from another state, cannot be reasonably expected to examine the public records, except in the state where the chattel now is, and where the proposed seller now resides. Assuming that he has diligently and properly made that examination, and, of course, found no record of an outstate security interest, how can it be held fair or just to him to construe the outstate recording as notice to him, constructive or otherwise?

A half-way recognition that giving extraterritorial effect to constructive notice is unsound is to be found in the provisions of the Uniform Conditional Sales Act which, while it provides that the outstate secured party's claim of priority shall continue in the Removal State, nevertheless requires the secured party to refile in the Removal State within ten days after he receives knowledge or notice of the place to which the chattel has been removed; otherwise he loses his priority as against subsequent bona fide subpurchasers.[31]

In a few states, the legislature has in effect prohibited the application of the rule of comity by providing that an outstate secured party shall not prevail over the subpurchaser in the Removal State unless he

28. Sims v. McKeen & Stimson, 25 Iowa 341 (1868); Smith & Co. v. McLean, 24 Iowa 322 (1868); Ord Nat'l Bank v. Massey, 48 Kan. 762, 30 Pac. 124 (1892).

29. Motor Fin. Co. v. Noyes, 139 Me. 159, 28 A.2d 235 (1942).

30. Philbrick, Limits of Record Search and Therefore of Notice, 9 U. Pa. L. Rev. 125, 135 (1944), citing 2 Tiffany, Real Property 2186 (2d ed. 1920), contends that a subsequent purchaser is charged with notice of an instrument only when "if he exercised proper diligence, he would by searching the records, discover the existence and terms of such instrument."

31. Uniform Conditional Sales Act § 14.

records his security interest contract in the Removal State prior to the subpurchase,[32] or within a fixed number of months after removal.[33] The requirement applies even though the chattel was removed without the consent of the secured party, and he has no knowledge of the place of removal.

Some courts contend that it is socially expedient to favor the outstate secured party, because to allow the subpurchaser to prevail would encourage fraudulent mortgagors and conditional vendees to move the subject chattel to a state where they could unlawfully dispose of the chattel free from encumbrance.[34] By giving judgment for the purchaser, it is asserted, the courts would be making the Removal State a party to the fraud. An analogy is drawn with the case of a thief who steals a chattel from its true owner in one state and then sells it in another. Obviously, if the Removal State gave superior rights to the purchaser from the thief, it would, to that extent, be giving legal encouragment to the latter.

Such courts are, however, in error on two counts. In the first place, the analogy is ill-founded. The mortgagor or conditional vendee who sells the chattel to a bona fide subpurchaser is not a thief. Modern business practice and the growing number of legal decisions which reflect that practice, attribute most of the incidents of ownership to the mortgagor and conditional vendee and tend to restrict the proprietary rights of the secured party to a mere security interest.[35] The debtor has been given lawful possession of the chattel by the holder of the security interest. His sale may be fraudulent, it is true, but not without much color of right. In the second place, courts have not shrunk from giving a good faith buyer valid title even though the buyer acquired his rights from one who obtained title through fraud.[36] In such cases, the courts have not considered judgment for the good faith buyer reprehensible because tending to encourage the fraudulent party to acquire his title by fraud.

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32. Lee v. Bank of Georgia, 159 Fla. 481, 32 So.2d 7 (1947).

33. Ayares Small Loan Co. v. Maston, 78 Ga. App. 628, 51 S.E.2d 699 (1949).

34. Motor Investing Co. v. Breslauer, 64 Cal. App. 230, 221 Pac. 700 (1923).

35. "The conditional seller holds only a limited interest in the goods for the purpose of security for the purchase price. This is as readily seen when the deal is viewed in its legal aspects as in its business aspects." Vold, Sales 291 (2d ed. 1959).

36. "[I]f, after the seller delivers possession to the buyer pursuant to a sale induced by the buyer's fraud, the property has passed into the hands of a bona fide purchaser for value, the right of the original seller to recover the property is lost." 46 Am. Jur. Sales § 471 (1943), citing among others: Hickey v. McDonald, 151 Ala. 497, 44 So. 201 (1907); Baehr v. Clark, 83 Iowa 313, 49 N.W. 840 (1891); Sinclair v. Healy, 40 Pa. 417, 80 Am. Dec. 589 (1861); Long v. McAvoy, 133 Wash. 472, 233 Pac. 930 (1925), aff'd, 135 Wash. 696, 236 Pac. 806 (1925); Rice v. Cutler, 17 Wis. 351, 84 Am. Dec. 747 (1863).

MODERN STATUTORY AND CASE LAW

The legal power of one with less than complete ownership to transfer full ownership to a bona fide purchaser for value is being broadened and strengthened by modern statutory and case law.

Section 24 of the Uniform Sales Act provides that a person, possessing voidable title to goods, who sells them to a bona fide purchaser for value before his title has been avoided, gives absolute title to the purchaser.

In section 25, the Uniform Sales Act provides, in effect, that a seller of goods who has entirely parted with title by a sale to A, but remains in possession of the goods after the sale, may give good title to the goods through a second sale to B, provided B is a bona fide purchaser for value.

Here the doctrine of ostensible ownership through possession is implicitly recognized and enforced. The seller's mere retention of possession gives the second buyer a superior claim to the chattel, undoubtedly because he relied on the seller's possession as tantamount to title. Nobody—no court as far as is known, has ever criticized this provision on the ground that the statute, by validating the unlawful and unauthorized second sale, has encouraged the seller in possession to practice fraud. This statutory provision is a cogent indication of the instinctive feeling of fairness and justice in the doctrine of ostensible ownership, which is equivalent to an estoppel against the party who, though having secret property rights in a chattel, permits another's possession of the chattel to offer to the world the appearance of a chattel free from encumbrance.

What constitutes *voidable title* has been materially extended by modern case law and particularly by modern statute. For example, the Uniform Commercial Code provides that a person may give absolute title by sale to a bona fide purchaser, even though the seller in that transaction obtained title and delivery, (1) through deception as to his identity, no matter how the deception was accomplished; (2) through exchange of a check which is later dishonored; (3) although the transaction was a "cash" sale; or (4) though the fraud was of such a nature as to be punishable as larcenous under the criminal law.[37]

The cumulative force and effect of the extension of rights to the good faith buyer has been described as giving a kind of negotiability to chattels and as creating a species of "holder in due commercial course of goods."[38] This new concept applies with greatest force where the good faith buyer has made his purchase from a dealer who usually deals in the goods in question, and the purchase is made "in the ordinary course of

37. Uniform Commercial Code § 2-403.

38. Preface to Vold, op. cit. supra note 35, at x.

business."[39] One wonders whether we are not experiencing in America a twentieth century adaptation of the ancient English rule of "market overt." The rule was and is still law in England that a buyer at a recognized market or fair who purchases goods there from a dealer gains good title unless the true owner can prove that the goods were actually stolen.[40] It is interesting to note that by the custom of the City of London, every shop in the city is a market overt between the hours of sunrise and sunset, except on Sundays and holidays.[41]

CONCLUSION

In the light of these new principles, let us re-examine the legal position of the bona fide subpurchaser who, in the Removal State, has purchased a chattel there located in the possession of a debtor. Let us bear in mind that the debtor has been permitted to keep possession of the chattel by a secured party who, it is true, has by contract and by local law, at a prior time and in another state, achieved a legal position of priority in that state as to bona fide subpurchasers for value. But when the chattel is brought into the Removal State, the outstate secured party and the subpurchaser should have their respective claims examined de novo within the frame of reference of the events taking place in the Removal State and the local law applicable thereto. In this state, there is no record of the secured party's claim. His security claim is just as secret here as it would have been if unrecorded in the Contract State.

As between two innocent parties, it is a matter of natural justice to hold against one who by his act helps to bring about the situation which deceives the other innocent person. It may be argued that the secured party has done all that he reasonably could be required to do in order to prevent injury to innocent buyers. He has recorded his lien in the Contract State, as provided by the laws of that state, and he has, by his contract, forbidden the debtor to remove the chattel to another state without his knowledge and consent. However, the secured party has given physical possession of the chattel to his debtor. It is presumed that before he did so, he investigated the character and standing of the debtor. If the debtor has deceived him, he, the secured party, should take the risk of loss,[42] and not a later subpurchaser who has a reasonable

39. "The triumph of the good faith purchaser has been one of the most dramatic episodes in our legal history. In his several guises, he serves a commercial function: he is protected . . . to the end that commercial transactions may be engaged in without elaborate investigation of property rights and in reliance on the possession of property by one who offers it for sale or to secure a loan." Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057 (1954).

40. Pease & Chitty, Markets and Fairs 75 (1958).

41. Id. at 77.

42. See, e.g., Leary, Horse and Buggy Lien Law and Migratory Automobiles, 96 U. Pa. L. Rev. 455 (1948).

right to rely on the debtor's possession, and on whatever record search in the state of purchase a reasonable buyer would undertake.

Consequently, in view of traditional legal principles dealing with secret liens and the balance of *equities* between the parties, the bona fide subpurchaser should prevail.

There is, of course, less common law support for finding in favor of a bona fide subpurchaser where the security interest takes the form of a conditional sale, rather than that of a chattel mortgage. For instance, the chattel mortgage, as has been pointed out, has from very early times been considered a secret lien, void as against bona fide subpurchasers unless publicly recorded. The conditional sale, on the other hand, was traditionally considered to be a mere bailment, ripening into a sale only when the bailee had paid the full purchase price.[43] On this theory, since the bailee had no property interest in the chattel whatsoever, but merely a possessory interest, he could give no title at all to even the bona fide subpurchaser who bought the chattel without knowledge of the title reserved in the conditional vendor. But in the majority of the states this view no longer holds.[44]

Even in the states that follow the old common law rule, the conditional vendee is given greater rights in the chattel than that of a mere gratuitous bailee.[45] Judge Learned Hand insists that the conditional vendee should be recognized as owner since he is actually considered so by the commercial community.[46] States which declare that conditional sales are chattel mortgages say in effect that the conditional vendor's security interest is a mere lien, and so ownership is in the vendee.

The enactment of the recording provisions[47] of the Uniform Conditional Sales Act and similar state statutes is in effect a legislative condemnation of the conditional vendor's secret security interest, similar to that concerning chattel mortgages. These provisions also, as in the case of chattel mortgages, establish that the secured party's priority over subsequent subpurchasers is not due to his security contract but ensues from the act of recording which is extrinsic to the contract.

Suppose the rule is universally adopted that, except as to stolen goods,

43. See, e.g., Glenn, The Conditional Sale at Common Law and as a Statutory Security, 25 Va. L. Rev. 559, 574 (1939); Vold, The Divided Property Interest in Conditional Sales, 78 U. Pa. L. Rev. 713 (1930).

44. Vold, op. cit. supra note 35, at 291.

45. Ibid.

46. In Re Lake's Laundry, Inc., 79 F.2d 326, 328 (2d Cir. 1935) (dissenting opinion).

47. Uniform Conditional Sales Act § 5.

possession implies ostensible ownership and the risk of loss is thus placed on the holder of the security interest. The financial institutions, which are the principal agencies for sales financing through security transactions of the kind under discussion, are well able to take the financial burden involved in the relatively small number of cases of unauthorized chattel removals. If the secured parties do not wish to take this risk for themselves, there are means of insuring against the risk and passing on the insurance costs as expenses of the security transaction.

But one is still met with the unsatisfying necessity of choosing in favor of one innocent party and against another. A procedure which would be fair to both parties would be the establishment of a national recording act providing a central agency at which a secured party might record the security instrument and thus give constructive notice to all purchasers throughout the United States.[48] The federal statute should provide that in the event the secured party fails to file under the national law, and the chattel is subsequently removed to another state, a bona fide purchaser in the Removal State will take free of the security interest. By restricting application of the federal recordation act only to those transactions in which the chattel is moved across state borders, administrative difficulties would be materially reduced, and the constitutionality of the exercise of federal power might be assured. By using the language and procedure proposed herein, the rights of the secured party would be cut off by the statute only if the chattel is moved across state lines. The rights of the secured party would not be affected by the federal statute as long as the chattel remained in the state in which it was located at the time the security contract was made. The federal recordation act would therefore be a proper exercise of constitutional power to regulate interstate commerce. Federal recordation as a prerequisite to maintaining the priority of security interests is not new. It is now established and in practice with regard to the transfer of interests in airplanes,[49] ships,[50] patents,[51] and federal copyrights.[52]

48. "Since federal ability to establish an exclusive recordation system for moveables derives more correctly from the general power of Congress over interstate commerce . . . chattels other than air and water craft might also be covered by federal statute. . . . A single centralized system would fully protect both lienor and purchaser." Note, Federal Recordation of Title to Intrastate Aircraft, 48 Colum. L. Rev. 1248, 1250 (1948).

49. Interstate Commerce Act, 72 Stat. 772 (1958), 49 U.S.C.A. § 1403 (Supp. 1958) (Federal Aviation Program).

50. Ship Mortgage Act of 1920, § 30c, 41 Stat. 1000 (1920), 46 U.S.C. § 921 (1952).

51. United States Patent Act, 35 U.S.C. § 261 (1952).

52. United States Copyright Act, 17 U.S.C. § 30 (1947).

While the extension of this procedure to other more numerous security interests creates a larger administrative problem, the only practical difficulty is the size which such an agency must assume in order to be effective. With the machines currently available for handling voluminous detail, these administrative difficulties are not at all insurmountable.

In view of the growing interstate flow of persons with chattels, especially automobiles, which are covered by security interests, a solution of the problem through federal recordation is almost a matter of social necessity.