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# Dominion and the Factor's Lien: Does Section 45 of the New York Personal Property Law Abrogate the "Dominion Rule"?

## Cover Page Footnote

Member of the New York Bar. The author wishes to express his gratitude to Peter F. Coogan, Esq., Lecturer on Law, Harvard Law School, for his help and encouragement in the preparation of this article.

# DOMINION AND THE FACTOR'S LIEN: DOES SECTION 45 OF THE NEW YORK PERSONAL PROPERTY LAW ABROGATE THE "DOMINION RULE"?

*ROBERT M. ZINMAN**

## I. THE PROBLEM

IT HAS been 36 years since Mr. Justice Brandeis' famous decision in the case of *Benedict v. Ratner*.[1] The dust which it raised has settled, but many of the problems it presented still trouble the legal community. The *Benedict* decision held that under the law of New York, assignments of accounts receivable were void in law as to creditors if the assignor was allowed to sell, collect, or otherwise dispose of the assigned accounts for his own benefit without accounting to the assignee. This right of disposal for one's own benefit is referred to as "dominion."

Mr. Justice Brandeis based his decision on a line of New York cases which held that reservation of dominion in the hands of a mortgagor, assignor, or pledgor of *tangible* property made such mortgage, assignment, or pledge void in law as to creditors. In discussing this pre-*Benedict* line of cases, Justice Brandeis said that it is possible that Section 45 of the New York Personal Property Law, popularly known as the "Factor's Lien Act," "does away with the rule 'that retention of possession by the mortgagor with power of sale for his own benefit is fraudulent as to creditors,' " provided, of course, that the formalities and filing provisions of the section are complied with.[2]

The New York Factor's Lien Act,[3] enacted in 1911 and amended

* Member of the New York Bar. The author wishes to express his gratitude to Peter F. Coogan, Esq., Lecturer on Law, Harvard Law School, for his help and encouragement in the preparation of this article.

1. 268 U.S. 353 (1925).

2. Id. at 361 n. 11. While there is no citation for the quote at the conclusion of Justice Brandeis' footnote, it appears to come from a law review article by Dean (later Mr. Chief Justice) Harlan F. Stone, entitled The "Equitable Mortgage" in New York, 20 Colum. L. Rev. 519, 533 (1920). Dean Stone seems more certain than Justice Brandeis that the act does away with the "dominion rule." He says it "may . . . be presumed" that such is the case. He seems to say that section 45 was adopted for the purpose of overcoming the decision in Rochester Distilling Co. v. Rasey, 142 N.Y. 570, 37 N.E. 632 (1894), which held that a mortgage of after-acquired property, even though recorded, is merely an executory agreement to give a lien and that some further act is necessary after the property comes into existence in order to make it a valid lien as to creditors. While such may have been an incident of the passage of the act, it was not its purpose, as we shall see. Even so, it does not necessarily follow from the fact that the act overcame the New York rule with respect to after-acquired chattels, that it overcame the New York rule with respect to reservation of dominion.

3. N.Y. Sess. Laws 1911, ch. 326, § 1, amended by N. Y. Sess. Laws 1931, ch. 766, N.Y.

several times thereafter, was the first law of its kind in New York to grant to a lender a non-possessory lien on a shifting supply of merchandise; the first New York statute to effectively adapt inventory to serve as collateral for loans.[4] It applies not just to "factors," for the use of the term is a misnomer, but was "designed for the benefit of the widest possible class of lenders, including banks. . . ."[5] It has been widely copied throughout the country and has "clearly influenced" such modern legislation as the "Secured Transactions" article[6] of the Uniform Commercial Code.[7] But whether it does what Justice Brandeis suggested —allow the borrower to exercise dominion over the factored merchandise —has not, as yet, been authoritatively answered in New York.

As late as June 1958, federal district court Judge James T. Foley, while holding that dominion had not been reserved by the lienee, said that if dominion had been reserved, the fact that section 45 had been complied with, would, in his opinion, have preserved the lien.[8] His decision attached great importance to Justice Brandeis' footnote.

However, the history of the "dominion rule" in New York and its application to accounts receivable in *Benedict v. Ratner*, and an analysis of the development of section 45, the reasons for its enactment, and the purpose of the later amendments indicate that Justice Brandeis was incorrect in his supposition that the "dominion rule" is abrogated by

Sess. Laws 1935, ch. 690, N.Y. Sess. Laws 1943, ch. 635, N.Y. Sess. Laws 1954, ch. 594, as amended, N.Y. Pers. Prop. Law § 45.

4. Fechteler, The Factor's Lien Statutes, 11 Bus. Law 60 (April 1956).

5. Ibid. The act defines "factors" to include any "consignees . . . or pledges, who advance money on goods consigned to and/or pledged with them, whether or not such consignees or pledgees are employed to sell such goods and their successors in interest." N.Y. Pers. Prop. Law §45. Most observers today believe that the problem of losing a lien because the lienor is not considered a "factor" is very remote. "The title is a misnomer in some respects, since the device may be used by any financial agency, whether bank, finance company, or factor." Burman, Practical Aspects of Inventory and Receivables Financing, 13 Law & Contemp. Prob. 555, 563 (1948). "As used in the statutes, the word 'factor' is usually broad enough to include all or almost all lenders on merchandise." Skilton, The Factor's Lien on Merchandise (pt. 1), 1955 Wis. L. Rev. 356.

6. Uniform Commercial Code art. 9.

7. Coogan & Bok, The Impact of Article 9 of The Uniform Commercial Code on the Corporate Indenture, 69 Yale L.J. 203, 204 (1959). The influence of the Factor's Lien may also be seen in New York legislation covering various aspects of inventory financing such as the Uniform Trust Receipts Act, N.Y. Pers. Prop. Law §§ 50-58 and the recently expanded N.Y. Lien Law § 230(c).

8. Matter of Cut Rate Furniture Co., 163 F. Supp. 360 (N.D.N.Y. 1958). See Law Revision Commission, Communication and Study Relating to Assignments of Accounts Receivable, N.Y. Leg. Doc. No. 65(K), p. 162 (1946), where it is said: "Whether Benedict v. Ratner applies to a factor's lien on merchandise and its proceeds . . . completed by [complying with section 45] . . . is not clear."

section 45. Such a result was never intended by the drafters of the act. Indeed, the purpose of the legislature in enacting section 45 would not admit of such a construction. When *Benedict v. Ratner* was decided, only the original Factor's Lien Act of 1911[9] had been adopted. Subsequent amendments and revisions of the act only strengthen the view that the common-law "dominion rule" is still applicable.

## II. The New York "Dominion Rule."

### A. *Pre-Benedict*

As early as 1837, a New York court in the case of *Wood v. Lowry*,[10] held that a recorded mortgage of merchandise was fraudulent and void as to creditors if the mortgagor had the right to sell or otherwise dispose of the merchandise subject to the mortgage for his own benefit. Subsequent decisions went further, holding that even where the mortgage did not give the mortgagor dominion, the mortgage would still be void in law, if the mortgagee, in fact, intended or allowed the mortgagor to exercise such dominion over the mortgaged chattels.[11] In *Russell v. Winne*,[12] the court held, *inter alia*, that if a mortgage is fraudulent as to creditors with respect to a part of the property, it cannot be upheld as to the residue because "the fraudulent design . . . destroys the foundation of the entire instrument."[13]

It does not follow, however, that the "dominion rule" voided all mortgages of merchandise when the mortgagor retained possession and the power of sale. The "dominion rule" is applicable only where the power of sale is for the mortgagor's own benefit. Thus, a mortgage was held valid when the mortgagor, given the power to sell the mortgaged property, was required to apply the proceeds to the payment of the debt which the mortgage secured, or to purchase other property which would become subject to the mortgage.[14]

It was generally felt that the "dominion rule" was based upon the doctrine of "ostensible ownership." The "rule" was severely criticized

9. N.Y. Sess. Laws 1911, ch. 326, § 1; see note 3 supra.

10. 17 Wend. 492 (N.Y. Sup. Ct. 1837).

11. See Edgell v. Hart, 9 N.Y. 213, 59 Am. Dec. 532 (1853); Griswold v. Sheldon, 4 N.Y. 581 (1851).

12. 37 N.Y. 591, 97 Am. Dec. 755 (1868).

13. Id. at 596, 97 Am. Dec. at 758.

14. Brackett v. Harvey, 91 N.Y. 214 (1883). But see Skilton v. Codington, 185 N.Y. 80, 90, 77 N.E. 790, 793 (1906), where the court held invalid a mortgage giving the mortgagor the right to sell the goods and requiring him to apply the proceeds to the payment of the debt because the mortgagor was allowed to except from the proceeds to be applied to the debt "such portion thereof as is necessary for the expenses of the business or as he or they may need to replenish or increase the said stock of goods."

on the ground that the "whole doctrine of reputed ownership had been embodied in the recording statutes, and that recording satisfies the requirement and gives ample protection to creditors."[15] The court in *Wood v. Lowry* argued that the filing statute "only adds another to the grounds on which a mortgage of personal chattels shall be void. . . . If it was before void on another ground, filing it could not make it valid."[16] Basically, the courts thought that the general creditor could not be expected to search the records for a chattel mortgage, and would be more likely to rely on appearances.[17]

### B. *Benedict v. Ratner*

Prior to *Benedict,* New York never applied the doctrine of "ostensible ownership," and thus the "dominion rule," to accounts receivable. Presumably this was because the accounts, being intangibles, were thought to be incapable of being ostensibly owned. As a result, there is no requirement for recording such assignments in New York. Consequently, the court in *Stackhouse v. Holden,*[18] held that the retention of dominion by the assignor of accounts receivable did not render the assignment void because "the rules pertaining to . . . the dominion required to be exercised by a purchaser, mortgagee or pledgee of tangible property, cannot be applied to a sale or pledge of indebtedness, intangible of itself, only the evidence of which if in writing is perceptible . . . ."[19] It was, therefore, with some surprise, and chagrin, that the financial community read the decision of the United States Supreme Court in *Benedict v. Ratner* which purported to apply the law of New York, but which "lifted the rule circumscribing the mortgaging of stock in trade held for resale and with a heavy thump dropped it into the field of accounts receivable transactions."[20]

The *Benedict* case involved an assignment by a corporation of its present and future accounts receivable more than four months before it was adjudged bankrupt. Although lists of accounts outstanding were delivered to the assignee each month, the assignor retained freedom to collect the accounts without being required to remit the proceeds to the

15. Memorandum From the Executive Secretary and Director of Research of the New York Law Revision Commission to Governor Thomas E. Dewey, received by Counsel to the Governor April 16, 1943; see note 59 infra.

16. 17 Wend. 492, 496 (N.Y. Sup. Ct. 1837).

17. Robinson v. Elliott, 89 U.S. (22 Wall.) 513, 525 (1874); Weeks, "Floating Liens" in Inventory Financing, 1956 U. Ill. L.F. 557, 559; Note, 101 U. Pa. L. Rev. 392, 396-97 (1952).

18. 66 App. Div. 423, 73 N.Y. Supp. 203, (4th Dep't 1901) (per curiam).

19. Id. at 427, 73 N.Y. Supp. at 205.

20. Cohen & Gerber, Mortgages of Accounts Receivable, 29 Geo. L. J. 555, 559 (1941).

assignee, to substitute new accounts, or to account in any other manner.[21]

The Court overruled both the district court decision of Judge Learned Hand[22] and the Second Circuit Court of Appeals decision of Judge Mayer,[23] both of which had held assignment of the accounts receivable in question to be valid. It rejected *Stackhouse v. Holden*[24] because it was a decision by an intermediate appellate court, had not been cited by any New York court, had a strong dissenting opinion, and was "perhaps" distinguishable on its facts.[25] It held the assignment void under the "dominion rule."

Mr. Justice Brandeis maintained that the "dominion rule" was not based upon "ostensible ownership," but rather was based upon a conceptual repugnancy between the interest purportedly assigned and the power retained.[26] The parties had not achieved what they had set out to accomplish. Said the court:

> [I]t is not true that the rule . . . is either based upon or delimited by the doctrine of ostensible ownership. It rests not upon seeming ownership because of possession retained, but upon lack of ownership because of dominion reserved.[27]

An assignment which retains dominion in the assignor is just as repugnant to the idea of an assignment as a mortgage which reserves dominion in the mortgagor is to the idea of a mortgage. Since ostensible ownership was not the basis of the decision, the fact that the recording did or did not take place was irrelevant. On this basis, the "dominion

21. However, the creditor could at any time demand that the security be turned over to him. See testimony of Aaron Ratner, creditor, in record: "[T]hey said they could do it providing they made arrangements that they should . . . keep on collecting the checks and everything until I find it advisable that I should call it in but if ever I did not find it advisable in any way or manner so that nobody should know about it and they should keep on collecting the checks . . . and using the money." Record, p. 27, Benedict v. Ratner, 268 U.S. 353 (1925).

22. In re Hub Carpet Co., In Bankruptcy No. 30,396, S.D.N.Y., November 14, 1921.

23. 282 Fed. 12 (2d Cir. 1922).

24. 66 App. Div. 423, 73 N.Y. Supp. 203 (4th Dep't 1901). For a criticism of the tenuous grounds of the court's rejection of this case see Cohen & Gerber, Mortgages of Accounts Receivable, 29 Geo. L. J. 555, 561-62 (1941).

25. 268 U.S. at 365.

26. In Brown v. Leo, 12 F.2d 350 (2d Cir. 1926), a decision holding an otherwise valid mortgage on land void because a mortgage on chattels in the same instrument was invalid under the "dominion rule," Judge Learned Hand interpreted Benedict as follows: "[T]he doctrine has nothing to do with ostensible ownership. Therefore it can rest only upon some supposed conceptual repugnancy between the mortgage and the reserved power, quite regardless of any evils which may result from their coupling . . . . [T]he law of New York finds an obliquity in coupling with the lien a beneficial power in the mortgagor to sell the goods, quite aside from any false credit he may so procure." Id. at 351.

27. 268 U.S. at 362-63.

rule," right or wrong, loses its inconsistencies. The clarity of this reasoning however, is marred by references in the decision to fraud. Immediately following the quoted portion in the above paragraph the Court says: "It does not raise a presumption of fraud. It imputes fraud conclusively because of the reservation of dominion inconsistent with the effective disposition of title and creation of a lien."[28] Thus while Justice Brandeis "uses language which indicates that not enough was done to create a transfer, the element of fraud was clearly in his mind."[29]

Whatever its basis, whatever its inconsistencies, whatever its logic, whatever its desirability—the "dominion rule" is part of the law of New York and it extends both to tangibles and to intangibles.[30]

## III. Section 45 of the New York Personal Property Law

When the first Factor's Lien Act was passed in 1911,[31] the "dominion rule" was already an established feature of New York law. This act,

28. Id. at 363.

29. Coogan & Bok, The Impact of Article 9 of The Uniform Commercial Code on the Corporate Indenture, 69 Yale L.J. 203, 239 n. 126 (1959). "The natural inference that the Justice intended no drastic departure from accepted concepts is strengthened by his imputation of fraud, which goes to reinforce the idea that he is dealing with fraud on creditors, and not with a mere failure to make a transfer." MacLachlan, Bankruptcy § 232, at 267 (1956). It has been suggested that "the moving policy behind the Benedict rule may . . . be that, as a preventive measure, fraud should be presumed as a matter of law where there has been no policing, because of the danger that during the time there was no policing there also was no assignment." Note, 101 U. Pa. L. Rev. 392, 396 (1952). See also Pemberton, Notice Filing for Assignments of Accounts Receivable, 13 Law & Contemp. Prob. 643, 653 n. 38, 660 (1948). The argument made is that since there is no requirement that assignments of accounts be recorded there is nothing to prevent predating of assignments in order to give a preference to an unsecured creditor. While Justice Brandeis may well have been thinking of this type of fraud, it seems doubtful that he would give it any great weight in a decision he based upon a line of cases in which, due to the recording statutes, this type of fraud would be impossible. Since the parties could not pre-date a recording, they could not pre-date the chattel mortgage.

30. In order to avoid the application of the "dominion rule" the creditor must "police" the debtor to insure that he does not exercise dominion for his own benefit. If the creditor requires that the debtor turn over the proceeds to him, he can then make new advances, crediting the debtor with the payment of the older loans, and escape application of the "dominion rule." See Miller, An Assignment of Accounts Receivable as a Security Device, 22 Marq. L. Rev. 28 (1937). Other methods of avoiding the rule have been tried, some successfully. See In re New York, N.H. & H.R.R., 25 F. Supp. 874 (D. Conn. 1938), where a form of conditional assignment was upheld; Matter of Cut Rate Furniture Co., 163 F. Supp. 360 (N.D.N.Y. 1958), where the court held that no dominion was reserved even though the lienee had dominion over down payments received, because the filed factor's lien did not purport to cover these down payments. For a discussion of the application of Benedict v. Ratner to various fact situations see Taylor, The Collection of Assigned Receivables, 25 Minn. L. Rev. 201 (1941); Note, 24 N.Y.U.L. Rev. 598 (1949); Note, 101 U. Pa. L. Rev. 392 (1952).

31. N.Y. Sess. Laws 1911, ch. 326, § 1.

unamended, was in force when *Benedict v. Ratner* applied the "dominion rule" to accounts receivable in 1925. It was this act that Justice Brandeis was referring to when he said it was possible that section 45 abrogated the "dominion rule." Section 45 was later amended in 1931,[32] 1935,[33] 1943[34] and 1954.[35] After a discussion of the original act, each amendment will be considered seriatim, in order to determine the validity of Justice Brandeis' suggestion.

### A. *The 1911 Act*

The 1911 act had its origins in the metamorphosis of the factor in the latter part of the 19th century from a commission merchant to a new kind of commercial banker. Modern factoring grew up largely with the garment industry[36] where commission merchants represented New England or foreign mills. The factors settled in New York along Fourth Avenue, and became known as "Fourth Avenue Houses."[37] New York was selected because of its key position in foreign trade, its huge textile industry, and its growing number of credit rating agencies.[38]

Originally, the distant manufacturer, out of touch with the market, consigned goods to the factor for sale. The factor had a lien for his commissions on the manufacturer's goods in his possession.[39] As the factor developed specialized knowledge of the financial responsibility of his customers, he sold the manufacturer's goods on credit, and because he generally held himself liable if the purchaser failed to pay, he was

32. N.Y. Sess. Laws 1931, ch. 766.

33. N.Y. Sess. Laws 1935, ch. 690.

34. N.Y. Sess. Laws 1943, ch. 635.

35. N.Y. Sess. Laws 1954, ch. 594.

36. Actually factoring is a very old enterprise and there is evidence that it made a substantial contribution to the commerce of ancient Rome. As explained in Silverman, Factoring as a Financing Device, 27 Harv. Bus. Rev. 594, 595-96 (1949), "The term 'factor' is derived from the Latin verb, facere, to make or do, and means one who brings about or accomplishes things." Wealthy Romans would hire a factor to dispose of the produce of their estates. During the early colonial period of the British Empire, not only miles but a great deal of time separated the English manufacturers from their customers in the East and the New World. They found it "unsatisfactory, and sometimes impossible, to make direct contact with customers in the colonies. . . ." Ogline, The Factors' Lien Act as a Method of Inventory Financing, 4 W. Res. L. Rev. 336, 337 (1953). Thus as the sun never set on the British Empire, so it never set on the factor, representing British companies and handling their affairs.

37. Note, 24 N.Y.U.L. Rev. 598 (1949).

38. Silverman, Factoring as a Financing Device, 27 Harv. Bus. Rev. 594, 595-96 (1949).

39. Kruger v. Wilcox, Ambler 252, 27 Eng. Rep. 168 (Ch. 1755), was the first case to hold that a factor had a general lien on the goods and products of his principal in the factor's possession, not only for particular charges but also for the balance due on the general account. The common-law possessory lien was later enacted by the New York Legislature as N.Y. Sess. Laws 1830, ch. 179. It is now N.Y. Lien Law §182.

termed a *del credere* agent. The increased compensation charged by him for the extra risk assumed was known as a *del credere* commission.[40]

The factor prospered and was soon giving financial assistance to the manufacturer whose goods he sold. When goods were consigned to him for sale, the factor would advance money to the manufacturer to produce new goods. As long as the produced goods were consigned to the factor for sale, he had a valid possessory lien. The problem arose when the factor discontinued his selling function and loaned money to the industry secured by a lien on goods which he no longer possessed. This happened when many out of state mills placed their own salesmen in New York, and local manufacturers, growing in number and importance, began to handle their own selling. The factor, in many cases, concentrated on financing, leaving the selling to commission merchants. Where the factor was still in charge of sales it became next to impossible for him to concentrate all the articles consigned to him under his own roof. The expanding textile district had become subdivided into special areas for hats, silks, gloves, etc., and the factor could not maintain separate warehouses in each of these areas. The full circle had been turned—now it was the factor who was out of touch with the market.[41]

Consequently the factor lost possession of the goods, and with it his possessory lien. The problem was highlighted in the case of *Ryttenberg v. Schefer*.[42] There, the factor, Schefer, did not have possession of the goods,

40. Silverman, Factoring as a Financing Device, 27 Harv. Bus. Rev. 594, 597 (1949). The factor also had a lien on the goods in the hands of the purchaser for the purchase price. 3 Parsons, Contracts 287 (9th ed. 1904). An interesting account of the development of the practice of borrowing money by pledging open accounts or receivables can be found in 1 Seligman, The Economics of Installment Selling, 33-54 (1927). This type of del credere factoring was usually done on a notification basis. The factor would step into the shoes of the original vendor and notify the debtor to pay directly to him. It was not until later that there developed the so-called non-notification assignments under which the factor did not usually assume the risk of loss but merely advanced money on the security of assigned accounts receivable without notifying the debtor. This was the method used by the Hub Carpet Co. and Mr. Aaron Ratner. For a comparison of "factoring" and "accounts receivable financing" see Moore, Factoring—A Unique and Important Form of Financing and Service, 14 Bus. Law. 703, 724-25 (1959).

41. The development of this situation was explained fully by Assemblyman (later Governor) Alfred E. Smith, in his speech introducing the 1911 Factor's Lien Bill. See note 59 infra.

42. 131 Fed. 313 (S.D.N.Y. 1904). While this was only a district court opinion, it has been widely quoted and relied upon. Judge Holt had the benefit of excellent counsel. Arguing for the trustee in bankruptcy, the victor in the case, was Benjamin Cardozo. Charles Evans Hughes represented the factor. It is interesting to note that six years later, as governor, Mr. Hughes vetoed the first Factor's Lien Act because it did not contain enough safeguards against fraud. Had this act been in force when this case was decided, Mr. Hughes would have been victorious.

but "both parties wanted to give the defendants such a lien as a commission merchant usually has. . . ."[43] In order to achieve their goal, the warehouse lease was assigned to the factor and a sign was placed at the entrance to the floor reading: "Schefer, Schramm & Vogel, Annex." The court held this to be ineffective because in substance it was not the factor's premises and he could have been enjoined if he had tried to take possession. The sign was "indecisive" even though experts testified that in accordance with the custom of the industry, such a sign meant that the merchandise was subject to the lien of the named party.[44] Again in *Ommen v. Talcott*,[45] despite similar expert testimony, the court held that the sign "James Talcott, Annex" under the debtor's name was

> a not inappropriate designation of premises where the Baker Company conducted its business, and where Talcott also had quarters for the transaction of some business of his own. . . . It is absolutely essential to the validity of a factor's lien for advances that the property consigned shall be delivered by consignor to consignee.[46]

The lien was held invalid. But in *Boise v. Talcott*,[47] "a cumbersome possession by the factor did satisfy the court."[48] There the lease was assigned to Talcott who paid the rent. A clerk or custodian was supplied by Talcott to supervise during working hours. The signs were prominent and the wording clearly read, "James Talcott, Factor for Daly & Schaefer, Inc." In affirming the lower court decision, Judge Manton said, "Indeed, it is hard to conceive how the trade could have been more pointedly and carefully notified of the existence of the contract and the possession and management by Talcott."[49]

So the situation stood in 1910 when the legislature heard the pleas of the factors and sought to enact corrective legislation. The evil to be remedied was the inability of the factor to obtain a valid lien without actual possession or a cumbersome constructive possession as outlined in *Boise v. Talcott*.[50] A bill was proposed, and passed by both houses in 1910, which would have given the factor a non-possessory lien

43. Id. at 320.

44. Ibid.

45. 188 Fed. 401 (2d Cir. 1911).

46. Id. at 404.

47. 264 Fed. 61 (2d Cir. 1920), affirming 212 Fed. 268 (S.D.N.Y. 1914). Although this case was decided after the passage of section 45 in 1911, it involved a factoring agreement made on December 28, 1908.

48. Steffen & Danziger, The Rebirth of the Commercial Factor, 36 Colum. L. Rev. 745, 757 (1936).

49. 264 Fed. at 64.

50. Because the lien of the factor often involved after-acquired property, the chattel mortgage device was ineffective. Under New York law, a mortgage on chattels to be acquired in the future will be invalid as to creditors who become such before the property

provided that . . . there shall be placed a sign[51] or notice at the main entrance . . . stating the individual or firm name . . . in connection with words indicating the nature of the business conducted . . . and stating the place or address at which the principal office or place of business of such factors . . . is located. . . .[52]

The bill was vetoed by Governor Charles Evans Hughes on the ground that maintaining a sign was not sufficient to prevent secret liens and fraudulent transactions.[53] He suggested that an essential safeguard would be a requirement for filing a notice of lien in a public office.

In 1911 a bill, which met the Governor's specifications, was introduced by Assemblyman, later Governor, Alfred E. Smith and passed by the legislature. It became Section 45 of the New York Personal Property Law. It permitted a non-possessory lien provided there was both the posting of a sign and the filing of a notice. The bill provided that:

Liens upon merchandise or the proceeds thereof created by agreement for the purpose of securing the repayment of loans . . . made upon the security of said merchandise . . . shall not be void or presumed to be fraudulent or void as against creditors or otherwise, by reason of want of delivery to or possession on the part of the lienor, whether such merchandise shall be in existence at the time of the creation of the lien or shall come into existence subsequently thereto . . . provided there shall be placed and maintained in a conspicuous place at the entrance of every building . . . at which such merchandise . . . shall be located . . . a sign on which is printed . . . the name of the lienor and . . . provided further that a notice of the lien is filed. . . .[54]

As to the accounts which result from the sale of merchandise subject to the lien, the act stated:

If the agreement creating such lien shall also give the lienor a right to or lien upon accounts receivable resulting from . . . sales of the merchandise subject to the lien, . . . such right or lien shall not be void or ineffectual as against creditors or otherwise, by reason of want of possession of any such account on the part of the

comes into existence and before some further act is performed to create a lien upon it. See Rochester Distilling Co. v. Rasey, 142 N.Y. 570, 37 N.E. 632 (1894); Stone, The "Equitable Mortgage" in New York, 20 Colum. L. Rev. 519, 527-32 (1920). In his speech in favor of the bill, Assemblyman Alfred E. Smith said: "[T]he commission merchant . . . cannot secure [the loan] through a chattel mortgage as he would be required to file a new chattel mortgage upon the receipt of every piece of goods, and business exigencies make this impossible." See note 59 infra. For a discussion of the difficulties involved with other security arrangements see Cohen & Gerber, Mortgages of Merchandise, 39 Colum. L. Rev. 1338 (1939); Dunham, Inventory and Accounts Receivable Financing, 62 Harv. L. Rev. 588, 599 (1949); Note, 101 U. Pa. L. Rev. 392 (1952).

51. There seems to have been some later confusion on this point. In his address to the legislature in support of the 1911 bill, Mr. Smith said: "In 1910 a bill . . . was passed by the legislature . . . but was disapproved by Governor Hughes. That bill provided neither for maintaining the sign nor for filing of the notice . . . ." See note 59 infra.

52. N.Y. Senate No. 1068 (1910). See also N.Y. Assembly No. 1644 (1910).

53. For the text of the veto message see Public Papers of Governor Hughes, 1910, p. 197.

54. N.Y. Sess. Laws 1911, ch. 326, § 1.

lienor or by reason of failure to make or deliver a further assignment of any such account, provided a bill . . . or notice shall be mailed, sent or delivered to the person owing such account receivable, stating . . . the account is payable to the lienor, and such . . . notice shall have the same effect as a formal assignment of such account to the lienor named therein.[55]

There is certainly nothing in the words of the statute that would indicate that it does away with the "dominion rule." It merely says that a lien shall not be void because of want of possession, if a sign is maintained and a notice of lien is filed. It is quite a jump to imply from this language that the statute does away with the rule "that retention of possession by the mortgagor with power of sale for his own benefit is fraudulent as to creditors . . ."[56]—a rule which had been in existence for over seventy years at the time the act was passed. It is a well known maxim of construction that statutes are not to be construed as effecting any change in the common law beyond that which is clearly expressed.[57] Nevertheless it is true that a maxim of construction will not compel a meaning which is inconsistent with the purpose of the statute.[58] It is *possible* that the legislature in converting a factor's possessory lien to a non-possessory lien also meant to abolish the "dominion rule" with respect thereto. If this is so, it can be determined only in light of the purpose of the statute as indicated by its legislative history.[59]

55. Ibid.

56. Stone, The "Equitable Mortgage" in New York, 20 Colum. L. Rev. 519, 533 (1920).

57. Isbrandtsen Co. v. Johnson, 343 U.S. 779, 783 (1952); See 1 McKinney, Statutes §§ 153, 301 (1952).

58. Hart and Sacks, The Legal Process: Basic Problems in the Making and Application of Law 1412 (Tent. ed. 1958). For an excellent explanation of the process of statutory interpretation see id. at 1414-16. See also Breuer, Legislative Intent and Extrinsic Aids to Statutory Interpretation in New York, 51 Law Lib. J. 2, 6-7 (1958). Mr. Breuer, who is Law Librarian of the New York State Library, points out that legislative debates, when recorded, are seldom, if ever, printed or released to the public. There are practically no committee reports or records. He quotes Walter Gellhorn (Gellhorn, Foreword, 1946 New York State Legislative Annual at v): "[T]he courts of New York value . . . source material . . . . This material is used by the courts to show 'the evil aimed at,' that is, the purpose which was sought to be furthered by the legislative modification of existing law. It is with reference to this purpose that the effect of the statute is to be gauged, for courts will typically interpret doubtful language in a way which will achieve the supposed objectives of the Legislature."

59. In the light of the preceding footnote, we are very fortunate in the quantity of material available with respect to the legislative history of Section 45 of the New York Personal Property Law. There is a collection in the Legislative Reference Library of the New York State Library in Albany known as the Governor's Bill Jackets. They contain letters, studies, legal memoranda, and other material sent originally to the Governor or to the committee chairman and eventually submitted to the Governor urging him either to sign or veto a bill. Ernest K. Breuer, Law Librarian of the New York State Library, states that except for a few earlier isolated jackets, this collection exists from 1921 on.

We have already seen the mischief which the act was aimed at. This mischief was clearly indicated by Assemblyman Alfred E. Smith in his address to the legislature in support of the bill. After explaining how the mills produced goods with the factor's money and sent the finished product to New York for the factors to sell, he said:

> The commission merchant has found it impossible to concentrate the merchandise under his direct control and possession. And where the mill has become insolvent its creditors have in a number of important cases asserted that the commission house, because it did not have direct and immediate control of the goods, had no valid lien thereon. . . . Recent decisions . . . deter the commission merchant from entering into important and legitimate business. . . . *All that the bill does is to substitute public notice for actual possession of the goods. It does not create a lien which would have been otherwise fraudulent or void but only eliminates the necessity of possession by making the place of maintaining and filing of the notice a form of constructive possession of the goods.*[60]

One seldom finds a clearer statement of the purpose of a legislative enactment. The act sets up a method of obtaining constructive possession of goods which are out of the actual possession of the factor. "It does not create a lien which would have been otherwise fraudulent and void. . . ."[61] Prior to the enactment, a manufacturer could not exercise dominion over the goods on which the factor had a valid lien because the goods were in the factor's possession. There is no basis in the wording of the act or the purpose of the legislature to imply that in giving the factor a lien

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Thus there is no jacket for the 1911 act. However, the text of the legislative debates upon the third and final reading of the bill may be found in the Briefs for Appellant and General Motors Acceptance Corp. as Amicus Curiae, Utica Trust & Deposit Co. v. Decker, 244 N.Y. 340, 155 N.E. 665 (1927). Remarkably, the appellant's counsel obtained the assembly stenographer's own transcript of the debate in spite of the fact that it was not printed, although under assembly rules, the express permission of a member is required for the release of the transcript of his remarks. Breuer, supra note 58, at 5. However, once it has been released, the official stenographer's minutes may be considered by the court. People ex rel. Fleming v. Dalton, 158 N.Y. 175, 185, 52 N.E. 1113, 1116 (1899). It was considered by the court in Utica Trust. As to the amendments to section 45, there are relatively complete Governor's Jackets which Mr. Breuer and the Legislative Reference Library have made available for the purposes of this study.

60. Brief for Appellant, op. cit. supra note 59, at 23-24; Brief for General Motors Acceptance Corp. as Amicus Curiae, op. cit. supra note 59, at 19-20.

61. Brief for Appellant, op. cit. supra note 59, at 24. This statement is not wholly correct. The act gives the factor a lien on after-acquired property which, under a chattel mortgage, would have been void as to creditors. See note 50 supra. What Mr. Smith probably meant was that outside of giving the factor a non-possessory lien, the act left the factor in the same position vis-a-vis other rules of law as he was prior to the act. The factor's lien attached to after-acquired property prior to the act because the property was in the possession of the factor. The act contemplated a constructive possession and thus the lien attached as the goods came into the factor's constructive possession.

when the goods were not in his possession, the legislature meant to allow the manufacturer to exercise dominion he could not have exercised before.

Such a possible future construction of the act was clearly brought to the attention of the legislators by an opponent of the bill. Assemblyman (later Justice) Hinman in objecting to the bill on the ground that it was loosely drawn said:

> There is nothing . . . to prevent the manufacturer from entering into an agreement with creditors having such liens, permitting the manufacturer to sell the goods on his own account and replace them later with goods not then in existence; which the law at the present time holds would be absolutely void . . . and fraudulent as to creditors of a chattel mortgagor entering into such an agreement. I, therefore, believe that this bill, while right in principle, is loosely drawn and lacking still in essential safeguards; and should not be passed in its present form.[62]

Mr. Hinman's apprehensions did not impress the legislature, and when Mr. Smith moved the previous question there were ninety-seven ayes and eighteen noes. The bill was passed.

From the objection of Mr. Hinman it is clear that he did not believe the bill was intended to do more than Mr. Smith *said* it was intended to do. "I do not question the principle of the bill; that is justified in my mind . . . ,"[63] he said. His objection was that there was nothing in the bill to prevent its misinterpretation. And misinterpreted it was. But it should be clear that at least as of 1925, when *Benedict* was decided, section 45 did not do away with the rule "that retention of possession by the mortgagor with power of sale for his own benefit is fraudulent as to creditors."[64]

62. Id. at 28. The transcript following Mr. Hinman's remarks is as follows:

Mr. Oliver: Would it have an effect on your learned dissertation if you knew that this bill had been considered for over a year by the greatest mercantile body or association . . . whose duty and whose aim is to keep the manufacturer of the United States busy; and to see that they get honored return for their goods—known as the Chamber of Commerce, the greatest body of American gentlemen in the United States of America?

Mr. Smith: Except the legislature—[Laughter]

Mr. Hinman: I think there is no question that the gentlemen who have drawn this—

Mr. Oliver: My question was, would it affect the address that you make even in that learned dissertation of yours on the law—

Mr. Hinman: I think it might fortify it, Mr. Oliver. [Laughter]

Mr. Smith answered by saying that "it ain't possible to make men honest by legislation. [Laughter] . . . . You can say that the bill is loosely drawn . . . but the man that drew that bill is the author of the leading standard work on [sic] this state on the Lien Law." Attempts to determine who this anonymous author was, have thus far, been unavailing. However, the leading work on the Lien Law of New York at the time seems to have been Snyder, The Lien Law of New York, (5th ed. 1909).

63. Brief for Appellant, op. cit. supra note 59, at 27; General Motors Acceptance Corp. as Amicus Curiae, op. cit. supra note 59, at 22.

64. Stone, The "Equitable Mortgage" in New York, 20 Colum. L. Rev. 519, 533 (1920).

### B. *The 1931 Amendment*

With the passage of the 1911 act, a factor's lien on merchandise or the proceeds thereof, whether or not in existence at the time of the creation of the lien, would not be held invalid for want of possession in the factor if the required sign were posted and the necessary notice filed. If the lien purported to cover accounts receivable arising from the sale of merchandise subject to the lien, it would not be invalid for want of possession of the account, or for failure to make further assignment, provided the person owing the account was notified to pay the factor. In no way did this act abrogate the "dominion rule" as suggested by Justice Brandeis in footnote 11 to *Benedict v. Ratner.*

Six years after *Benedict v. Ratner,* section 45 was amended.[65] A search of all the available legislative history shows no reference to the "dominion rule," *Benedict v. Ratner,* nor, *a fortiori,* footnote 11. Yet this amendment has been used to support the contention that section 45 abrogates the "dominion rule." The purpose of the amendment indicates that such is not the case.

> The primary purpose of the Bill is to clarify an existing law and to simplify the practice thereunder. It introduces no new principle, but rather confirms the principle of a statutory factor's lien recognized by the legislature in the adoption of the present section 45 . . . in 1911.[66]

The 1911 act was hardly a model of good draftsmanship.[67] It needed clarification in several respects. Although it stated that a lien shall not be void for lack of possession, it did not affirmatively give the factor a non-possessory lien. The factors found such a lien by implication uncertain and they continued to establish the possessory liens allowed in *Boise v. Talcott*[68] while, in addition, complying with the statutory provi-

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65. N.Y. Sess. Laws 1931, ch. 766.

66. The bill's purpose was thus stated in a "Memorandum for the Governor" submitted to Hon. Samuel I. Rosenman, Counsel to Governor Franklin D. Roosevelt, on April 6, 1931 by the law firms of Hughes, Schurman, & Dwight and Spencer, Ordway, & Wierum, in whose offices the amendment was drafted. [Hereinafter cited as Memorandum for the Governor]. See Letter From Spencer, Ordway, & Weirum to Governor Roosevelt, dated April 24, 1931 and received in the office of the Counsel to the Governor on April 25, 1931.

67. "Concerned with the immediate objective of dealing with a few decisions that had troubled them, [the legislature] . . . drafted an act which hindsight shows was poorly drafted. . . . Each amendment . . . was patchwork . . . . to remove a few glaring loopholes. . . . [T]he draftsmen of the original version lacked what Coleridge aptly called, 'the shaping spirit of imagination.'" Skilton, The Factor's Lien on Merchandise (pt.1), 1955 Wis. L. Rev. 356, 372. "The act is a model of bad drafting." Gilmore, Chattel Security: (pt.2) 57 Yale L.J. 761, 771 (1948).

68. 264 Fed. 61 (2d Cir. 1920).

sions. A leading factoring concern explained the problem to the Governor's counsel as follows:

It was undoubtedly intended by . . . [the act's] draftsmen that compliance with its requirements should be sufficient to protect the factor. However, in view of the fact that the language is negative, there is the possibility of an inference that the common law rule of actual possession . . . is still necessary. As a result of this, counsel for the factoring houses have been unable to affirmatively state that actual possession safely may be omitted. As a consequence, the factors have uniformly required the lienor to assign the lease of his premises and have felt obliged to maintain a custodian in the premises.[69]

Thus the statute "failed in perhaps its main purpose and at the same time added a new statutory requirement."[70] The amendment's "primary purpose [was] . . . to correct this situation by expressing in affirmative

69. Letter From P. W. Haberman, Esq., Vice-president and General Counsel, Commercial Investment Trust Inc., to Hon. Samuel I. Rosenman, Counsel to Governor Franklin D. Roosevelt, April 21, 1931. Comment to the same effect is found in a personal letter to Governor Roosevelt from an officer of Commercial Factors Corporation whose signature is not legible, dated April 1, 1931, who assured the Governor that "there is nothing concealed in the law and no ulterior motive in it . . . ." See Irving Trust Co. v. Commercial Factors Corp., 68 F.2d 864 (2d Cir. 1934), involving a factoring agreement dated August 16, 1926, in which Commercial Factors complied with the statutory provisions and also attempted to obtain a possessory lien. The district court held, inter alia, that the possessory lien was valid, while the court of appeals, in affirming that part of the district court's decision, found a valid statutory lien and did not decide the question of whether there was a valid possessory lien. The arguments in the above quoted letters were also made in the Memorandum for the Governor from the law firms that drafted the amendment. This memorandum pointed out that an additional evil the act would eliminate was "the too frequent practice of landlords in exacting from the factor an assumption of the lease before the landlord will consent to the assignment from the principal to the factor although the landlord well knows that the assignment is for security purposes only." See note 66 supra.

70. Report of the Committee on State Legislation of the Association of the Bar of the City of New York No. 123 (1931), approving the bill. This was the reason why the act was not extensively used, not, as some eminent observers have maintained, because it was too cumbersome. "The filing provisions are cumbersome and onerous and the privilege afforded by the statute has not been extensively used." Stone, The "Equitable Mortgage" in New York, 20 Colum. L. Rev. 519, 533 (1920). "[The statute's] requirements are so onerous that its privileges have been little used." Walsh, Mortgages of Property to be Subsequently Acquired, 10 N.Y.U.L. Rev. 311, 322 (1933). But see Steffen & Danziger, The Rebirth of the Commercial Factor, 36 Colum. L. Rev. 745, 753 (1936), where it is said that "actually nothing could be more simpler [sic] than the filing provided for. It was not necessary to describe . . . any particular merchandise, a broad designation . . . being sufficient. There was no requirement that the amount of the lienor's interest should be given. . . . And, when once filed . . . the notice continued effective for the period of the agreement." See also Fechteler, The Factor's Lien Statutes, 11 Bus. Law 69, 63 (April 1956), where it is said: "The statute worked very well in New York. . . ."

language that a factor shall have a lien upon the filing of the notice and maintenance of the appropriate signs. . . ."[71]

In spite of this evidence of intent, the change to affirmative language has been used to support the contention that the 1931 amendment abrogated the "dominion rule." The argument made is that the legislature intended to change the act from one merely proscribing invalidity because of lack of possession, to one prescribing validity regardless of already existing common law prohibitions. It should be clear from the above discussion that such was not the legislature's intention. The amendment read:

If so provided by any written agreement with their principals . . . all factors, consignees and commission merchants shall have a continuing general lien upon all goods and merchandise . . . consigned to . . . them, whether in their constructive, actual or exclusive . . . possession or not and upon any accounts receivable or other proceeds resulting from the sale or other disposition of such goods and merchandise. . . .[72]

A further addition was made to the statute at the request of the finance companies. These companies dealt in straight assignments of accounts receivable, generally on a non-notification basis. The accounts usually did not arise from the sale of merchandise subject to a section 45 lien, but were assigned to a lender as security for the payment of a loan, often without any notification to the debtor to pay the lender.[73] Until this amendment, straight assignments were not included within the statute which extended to accounts only when they arose from the sale of merchandise subject to the lien.[74] With the statute rewritten in affirmative language, these financial institutions feared that it would be interpreted to cover straight assignments, thus they would be required to comply with the provisions of the statute where previously a simple written assignment without notice to the debtor would suffice. As a result, the amendment was broadened to confirm the common law assignment right by providing for two alternate methods of assigning accounts arising from the sale of merchandise, whether or not such merchandise is subject to the lien.[75] If there were an agreement to assign and the

71. See Memorandum for the Governor, op. cit. supra note 66.

72. N.Y. Sess. Laws 1931, ch. 766.

73. See note 40 supra for a discussion of non-notification financing.

74. "Section 45 . . . contemplates the making of a loan on the security of merchandise of which the borrower will retain possession. It does not apply to an assignment of accounts as security." In re Bernard & Katz, 38 F.2d 40, 44 (2d Cir. 1930).

75. "In order that confusion shall not arise in instances where there is no general contract and bills and invoices are specifically assigned, there is an appropriate provision confirming the common law as declared in this state that a formal or specific assignment of an invoice shall be adequate in and of itself to evidence a loan thereon. This provision will cover the assignment of receivables to banks and other financial institutions who

debtor was notified to pay to the assignee, no "further assignment" was necessary. If, however, there were "any such further or formal assignment" such assignment alone would give the assignee a lien upon the account without notification to the debtor.[76] This addition was not intended to abrogate the "dominion rule." The memorandum prepared by the Executive Secretary and Director of Research of the Law Revision Commission in connection with the 1943 amendment[77] to section 45, stated: "[I]t seems clear that the proviso that the assignment is good against creditors if a specific assignment is delivered, irrespective of notice to the person owing the account, is not sufficient to exclude the rule of *Benedict v. Ratner*."[78]

These were the two major changes made by the 1931 amendment. In addition the terms "factor" and "factors" were defined to include all consignees or pledgees "who advance money on goods consigned to, and/or pledged with, them, whether or not . . . [they are] employed to sell such goods . . . ."[79] This was inserted "to make clear that a factor need not necessarily be a selling agent . . . . This paragraph merely states what is the recognized understanding of the term."[80] Other changes made by this amendment "were merely for the purposes of clarification."[81] For example, the provision in the 1911 act which said that an assignment of an account would not be invalid for lack of possession in the assignee was deleted because "obviously, there cannot be such a thing as possession of an account which is an intangible."[82] The required sign was now

would be prejudiced by a lack of definition in [this] respect. . . ." Letter From P. W. Haberman, Esq., Vice-President and General Counsel, Commercial Investment Trust, Inc. to Hon. Samuel I. Rosenman, Counsel to Governor Franklin D. Roosevelt, April 21, 1931. See Law Revision Commission, Communication and Study Relating to Assignments of Accounts Receivable, N.Y. Leg. Doc. No. 65(K) p. 151 (1946), where it is said: "This . . . clause is declaratory of the general rule obtaining in this state . . . that notice to the obligor is not necessary to perfect, against creditors, a present assignment of an existing chose in action."

76. See Bloch v. Mill Factors Corp., 119 F.2d 536, 538 (2d Cir. 1941), where the court said, "section 45 provides two alternative methods by which a merchant can give to a factor a lien upon his accounts receivable: first, by a general agreement that the factor shall have such a lien, which must be implemented by notice to each of the merchant's customers that the account is payable to the factor; and, second, by a separate assignment of each account to the factor of which he need not advise the customer."

77. N.Y. Sess. Laws 1943, ch. 635.

78. This memorandum was signed by John MacDonald and received in the office of the Counsel to the Governor on April 16, 1943.

79. N.Y. Sess. Laws 1931, ch. 766.

80. Memorandum for the Governor, op. cit. supra note 66. See also note 5 supra.

81. Memorandum for the Governor, op. cit. supra note 66.

82. Letter From P. W. Haberman, Esq., Vice-President and General Counsel, Commercial Investment Trust, Inc. to Hon. Samuel I. Rosenman, Counsel to Governor Franklin D. Roosevelt, April 21, 1931.

to be placed "at the main entrance to the store, loft or other premises,"[83] instead of at "the entrance" to the building.[84] Also, to avoid any negative implications from the affirmative wording, a provision was added that "nothing in this section shall be construed as an abrogation of the lien of a factor at common law . . ."[85]—the factor's possessory lien. This innocent provision was to cause a great deal of trouble.

There is, in addition, one sentence which has been quoted in support of the proposition that the "dominion rule" was abrogated by this amendment. The sentence reads: "This section [is] to be construed liberally to secure the beneficial interests and purposes thereof."[86] No mention of this sentence is made in the available legislative history and thus it appears that those concerned with the passage of the act did not think the provision affected significantly the rights of the parties under it. The amendment limits the liberal construction to securing the beneficial purposes of the act. Abrogation of the "dominion rule" was not one of the beneficial purposes of the act. Furthermore, the next sentence explains the application of this provision. It states "a substantial compliance with its [section 45's] several provisions shall be sufficient for the validity of a lien and to give jurisdiction to the courts to enforce the same."[87] In effect then, this provision says that if you fail to dot your i's or cross your t's, you will not lose your lien—and this is how the courts have interpreted it. In *Matter of Bloch Bros. Paper Co. v. Larkin*,[88] the court said:

> The fact that the factor's lien was orginally filed against Efficiency Direct Mail Service Inc. instead of Efficient Direct Mail Service Inc. does not invalidate the factor's lien. The Legislature apparently realizing that errors might be committed . . . added a paragraph to this section which to the court seems to cover the situation involved herein. This paragraph reads as follows: "This section is to be construed liberally. . . ."[89]

Nothing, then, in this amendment affected the application of the

83. N.Y. Sess. Laws 1931, ch. 766.

84. N.Y. Sess. Laws 1911, ch. 326, § 45. Apparently many people did not think of looking over the main entrance to a building which housed several manufacturing concerns. The New York County Lawyers Association considered this change "a distinct improvement." N.Y. County Lawyers Ass'n, Report No. 171, Committee on Legislation, by Wolcott H. Pitkin (April 3, 1931), recommending approval of the amendment.

85. N.Y. Sess. Laws 1931, ch. 766.

86. Ibid.

87. Ibid.

88. 198 Misc. 669, 102 N.Y.S.2d 1003 (N.Y.C. Munic. Ct. 1950). In order to understand why such a provision is necessary to accomplish this result, compare the strict interpretation given to the Uniform Trust Receipts Act in many jurisdictions. See General Motors Acceptance Corp. v. Haley, 329 Mass. 559, 109 N.E.2d 143 (1952).

89. 198 Misc. at 671-72, 102 N.Y.S.2d at 1005-06.

"dominion rule." Thus, as of 1931, retention of possession in the manufacturer with the power of sale for his own benefit should have resulted in an otherwise valid factor's lien being declared fraudulent as to creditors.

### C. *The 1935 Amendment*[90]

It could be said that the best laid schemes of the New York Legislature "gang aft a-gley" in the courts. For that is what happened in connection with the 1931 amendment to section 45.

The 1931 amendment defined "factors" as consignees, assignees, or pledgees who advance money on goods "whether or not such consignees or pledgees are employed to sell such goods."[91] At common law a factor was one employed to sell goods, but this amendment's definition of "factors" was consistent with the recognized understanding of the term in 1931, when factors had largely dropped their selling function.

The 1931 amendment also stated that it was not to be construed as an abrogation of the lien of a factor at common law.[92] This was, of course, the factor's possessory lien. The legislature wanted to make clear that one could obtain a lien on merchandise either by obtaining possession of the merchandise or complying with the statute. When the court in *Irving Trust Co. v. B. Lindner & Bro.*,[93] interpreted the amendment they construed it as a limiting provision. The court pointed out that the statute did not abrogate the lien of a factor at common law, but it did limit the common-law lien to factors who were "factors" at common law. Statutory factors under the 1931 definition, who were not employed to sell, had to comply with the notice requirements of the statute whether or not the merchandise subject to the lien was in their possession.

The court admitted that under the original act of 1911, a factor who did not sell could obtain either a possessory lien at common law or a statutory lien under the act, but concluded that the 1931 amendment imposed a new condition on non-selling factors. The court maintained that the act, as amended in 1931, clearly stated in *affirmative* language that the factor shall have a continuing general lien whether the goods were or were not in the factor's possession, provided the prescribed notice was given. Therefore, the court said, all statutory factors must comply with the act.

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90. N.Y. Sess. Laws 1935, ch. 690.

91. N.Y. Sess. Laws 1931, ch. 766; see note 79 and accompanying text.

92. See note 85 supra and accompanying text.

93. 264 N.Y. 165, 190 N.E. 332 (1934); see Skilton, The Factor's Lien on Merchandise (pt.2), 1955 Wis. L. Rev. 609, 618, where Professor Skilton suggests that this decision be "read for laughs."

The court indicated that the legislature intended such a seemingly untenable distinction because there was authority[94] in New York to the effect that if a factor obtained a secret non-possessory lien and the lienee transferred the property to the factor within four months of bankruptcy, the date of the transfer would relate back to the date of the secret agreement and complete the "equitable pledge." The 1931 amendment, the court maintained, was passed for the purpose of avoiding this result.[95] Clearly this was not the purpose of the 1931 amendment. It is remarkable that within only three years of the passage of the amendment, its purposes could be so completely forgotten and new ones so easily invented. It took the legislature only one year to correct this decision.

The new amendment was introduced by John A. Byrnes, Chairman of the Committee on Codes who stated in a memorandum to the Governor's counsel: "A brief reference to the nature of the modern factoring business will disclose the impractical results which will follow from the application of the [*Lindner*] decision."[96] Said the Association of the Bar of the City of New York:

> The purpose of the bill is to overcome the effect of the decision in . . . *Irving Trust Co. v. B. Lindner & Bro. Inc.* . . . To require a lienor to act as a selling agent in order to perfect his possessory lien is anomalous. This was not required before the 1931 amendment and no reason appears for requiring it now.[97]

On May 4, 1935, the amendment became law with the Governor's approval. It added the following paragraph:

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94. Parshall v. Eggert, 54 N.Y. 18 (1873).

95. 264 N.Y. at 175, 190 N.E. at 336. The legislature of 1935, apparently in order to make it clear that by modifying the Lindner decision it had no intention of modifying any effective equitable pledge that might be allowed under the Bankruptcy Act, (see Bankruptcy Act § 60(a), 30 Stat. 562 (1898), amended by 52 Stat. 869 (1938), as amended, 11 U.S.C. § 96(a) (1958)) changed the last sentence of the act from "nothing in this section shall be construed as an abrogation of the lien of a factor at common law," to, "nothing in this section shall be construed as affecting or limiting any existing or future lien at common law or any rights of a factor at common law." See N.Y. Leg. Doc. No. 65(K), p. 159 (1946).

96. Undated Memorandum From John A. Byrnes to Charles Poletti, Counsel to Governor Lehman.

97. Report of the Committee on State Legislation of the Association of the Bar of the City of New York No. 169 (1935). Similar comments supporting the amendment are found in a Letter From Hughes, Schurman & Dwight (one of the two law firms that drafted the 1931 amendment) to Governor Lehman, March 26, 1935; Memorandum for Governor Lehman From John J. Bennett, Jr., Attorney General, April 17, 1935; Undated Confidential Memorandum From The Director of Research, New York Law Revision Commission, received by Counsel to the Governor on April 19, 1935, signed by John MacDonald, containing a statement that the report was not submitted to nor passed upon by the Law Revision Commission itself.

When any factor or other lienor, or any third party for the account of any such factor or other lienor, shall have possession of goods and merchandise, such factor or other lienor, shall have a continuing general lien as set forth in the first paragraph of this section, without filing the notice and posting the sign provided for in this section.[98]

By inserting the words "or any third party for the account of any such factor or other lienor," the legislature cleared up another ambiguity in the application of the statute. In *Irving Trust Co. v. Commercial Factors Corp.*,[99] the court had held, *inter alia*, that the factor had no lien under section 45 on goods shipped from the lienee to the dyer and not delivered to the factor until within thirty-three days of the filing of the petition in bankruptcy. The court said that the requirements of the section (presumably the posting of a sign) had not been complied with in respect to these goods.[100] The addition of the above quoted phrase in "the 1935 amendment . . . apparently covers this situation."[101]

Again there is no mention in the legislative history of the "dominion rule" or of footnote 11. Obviously the amendment was not meant to change the law. Rather, it was designed to put the law back on the tracks after it had been derailed by the courts.

### D. *The 1943 Amendment*[102]

In 1943, the legislature adverted directly to the dominion problem when it invalidated the rule of *Lee v. State Bank & Trust Co.*,[103] with respect to straight assignments of accounts receivable. The *Lee* case, decided in 1930, purported to apply the "dominion rule" as expressed in *Benedict v. Ratner*. It held an assignment of accounts receivable invalid because the assignor was allowed to exercise dominion over the returned merchandise in spite of the fact that of the "$96,150.91 of assigned accounts, representing merchandise sold, some $6,600 worth of shoes had been re-

98. N.Y. Sess. Laws 1935, ch. 690.

99. 68 F.2d 864 (2d Cir. 1934).

100. Nevertheless the court upheld the lien of the factor as a valid common law pledge since the goods were not in the lienee's possession and the dyer was notified of the pledge. Id. at 866.

101. N.Y. Leg. Doc. No. 65(K) p. 156 (1946). In the Byrnes Memorandum, op. cit. supra note 96, it is said: "In other instances, the merchandise is temporarily 'located' at dyeing, printing, finishing and other manufacturing establishments. The goods were shipped to these establishments in the name of the factor and they hold the goods for the account of the factor. The goods were not shipped to be sold but to be manufactured. No purpose is served in posting a notice and again a needless burden is imposed upon the factor."

102. N.Y. Sess. Laws 1943, ch. 635.

103. 38 F.2d 45 (2d Cir. 1930).

turned by the buyers and accepted by [the] bankrupt . . ."[104] even though the agreement provided that any returned goods would be held in trust for the assignee. After this decision the factors attempted to prevent their borrowers from exercising dominion over returned merchandise. They required the manufacturer to "set aside, segregate, and tag in the name of the factor all goods which . . . [were] returned by customers."[105] But after "several years of . . . trying to make the best of it in actual business practice,"[106] the factors appealed to the legislature for relief. They claimed:

[W]e find that in practice it is impossible to educate the customers to notify us when they return goods or when they seek allowances, and they almost invariably return the goods directly to our clients and negotiate with them for allowances.

Sometimes the pressure of business, sometimes carelessness and at the present time also the shortage of manpower has resulted in our clients failing to notify us of the returns or allowances, and the first that we hear of them is when we ask for payment of our bills from the customers. . . .

Thus the fact that despite our constant vigilance a seller and a buyer of goods arrange between them for a small allowance, or the buyer returns goods directly to the seller, has the effect of invalidating a series of transactions which have been going on for a period of years.[107]

Whether or not these fears were completely justified[108] the legislature came to the aid of the factors by adding the following provision:

104. Id. at 46.

105. Letter From Thomas Jefferson Miley, Secretary, Commerce and Industry Association of New York, Inc., to Governor Thomas E. Dewey, April 12, 1943.

106. Livingston & Kearns, Commercial Financing and the Relation Between Secured and Unsecured Creditors in Bankruptcy, 13 Law & Contemp. Prob. 609, 613 (1948).

107. Letter From William H. Stonaker, President of Mill Factors Corp. to Charles D. Breitel, Counsel to Governor Dewey, March 24, 1943.

108. See In re L. Gandolfi & Co., 113 F.2d 300 (2d Cir. 1940). Here the court upheld an assignment despite the fact that the assignor failed to report some of the returned merchandise in violation of the terms of the assignment. The unreported returns were insignificant, amounting to less than 1% of the aggregate value dealt with. The court distinguished Lee v. State Bank & Trust Co., 38 F.2d 45 (2d Cir. 1930), on the ground that the amount of returns involved there was more significant, and because in Lee the assignee, "in effect, agreed to the free use of returned merchandise by the assignor," while in this case, as soon as the returns were discovered in audits, the assignee exercised control. "The doctrine of Benedict v. Ratner has been given wide range, but it seems plain that this case is beyond it." 113 F.2d at 301.

In the second case of Bloch v. Mill Factors Corp., 134 F.2d 562 (2d Cir. 1943), decided earlier in the same month that the 1943 amendment was enacted, the court held that the Lee rule will apply only if the assignee agrees to the exercise of dominion over the returned merchandise by the assignor. Mere acquiescence was not enough to invoke the "dominion rule." This decision did not satisfy the factors who tend to approach these problems cautiously. In a letter dated April 9, 1943 to Governor Dewey's counsel, George R. Fearon Esq., attorney to numerous factors, wrote of this case: "[I]t is apparent that the whole

If merchandise sold, or any part thereof, is returned to or recovered by the assignor from the person owing the account receivable and is thereafter dealt with by him as his own property, or if the assignor grants credits, allowances or adjustments to the person owing an account receivable, the right to or lien of the lienor or assignee upon any balance remaining owing on such account receivable assigned to him by the assignor shall not be invalidated irrespective of whether the assignee shall have consented to or acquiesced in, such acts of the assignor.[109]

The amendment answered some questions but the legislature missed a remarkable opportunity to clarify this whole area of law. Through a study of the legislative history, as it relates to the words of the amendment, it can be concluded that the amendment acknowledged by necessary implication, the applicability of the "dominion rule." If the "dominion rule" did *not* apply, there would have been no need for the amendment. The amendment abrogated an extension of the "rule," it did not abrogate the "rule" itself. The Law Revision Commission affirmed this view in 1946 when it said: "[T]he 1943 amendment . . . indicates an assumption on the part of the Legislature, that reserved dominion over the *assigned accounts*, as distinguished from the returned goods, will invalidate the whole transaction."[110] It can also be concluded that the amendment applies only to straight assignments of accounts receivable and not to liens upon accounts receivable which arise from sales of merchandise already subject to a section 45 lien. This is made clear in a memorandum prepared by Assemblyman Harry A. Reoux which sets forth in detail the reasons for the bill:

The amendment . . . is a further clarification of Section 45 and arises out of a problem involving the handling of returned merchandise *in those cases where the factor has a lien upon accounts receivable only, and not upon the merchandise of the assignor. The amendment does not in any way attempt to create a lien on*

situation is one of facts; that these facts will vary in different situations, and that no one can tell, on the basis of this opinion . . . just what a factor may do and what he may not do." In a letter to the author dated March 9, 1960, Walter D. Yankauer, Esq., now president of Mill Factors Corporation, who argued both Bloch cases, writes that in spite of the favorable decision reached in the second Bloch case he was "delighted to see the 1943 amendment to section 45." For the first Bloch case see 119 F.2d 536 (2d Cir. 1941).

109. N.Y. Sess. Laws 1943, ch. 635.

110. N.Y. Leg. Doc. 65(K) p. 162 (1946). See also Manchester Nat'l Bank v. Roche, 186 F.2d 827, 833 (1st Cir. 1951), where Judge Magruder, in interpreting a similar provision in the New Hampshire Factor's Lien Act, states: "The legislature . . . seems to have chosen . . . not to abrogate entirely the rule of Benedict v. Ratner but rather to qualify it, so as to render it inapplicable to certain extreme situations in which Benedict v. Ratner had been held applicable. . . . Certainly these restrictions . . . would have been superfluous, except upon the assumption that . . . retention by the borrower of dominion over his accounts receivable would render his purported assignment of such accounts void as against his creditors."

*such returned merchandise* but has to do solely with the effect of returns upon the validity of accounts receivable assigned to the factor.[111]

It is probable that the legislature made such a distinction because a factor who holds a straight assignment of accounts never has a lien on merchandise from which these accounts arose.[112] When the merchandise is returned it is just as if the sale had never been made.[113] On the other hand, when the factor's lien is on merchandise and the proceeds thereof, the accounts receivable arose from the sale of merchandise which was subject to the lien. Upon sale, the lien moves from the merchandise to the account, and if the account is dissolved and the merchandise returned, the lien reverts to the merchandise. The legislature must have felt that there was no reason why the lien should cease and the merchandise become subject to the unfettered dominion of the manufacturer merely because the merchandise was returned. As a result, the legislature did not abrogate the holding in *Lee* on this point. Moreover, there really was no problem in connection with the lien on merchandise and its proceeds because, by its terms, the lien would ordinarily cover all merchandise regardless of whether it had once been sold, and in practice the factor would have little difficulty in policing the returns since he already had a merchandise policing system in operation.

It should be noted that nothing in the amendment affects the fact that the "dominion rule" is applicable to liens on merchandise and the proceeds thereof created under section 45. The amendment did not attempt

111. Letter From the Hon. Harry A. Reoux to Charles D. Breitel, Governor's Counsel, April 5, 1943, accompanying the memorandum in support of the amendment, both received by Counsel to the Governor on April 6, 1943. (Emphasis added.) Mr. Reoux, who introduced the bill served as an ex-officio member of the Law Revision Commission that prepared N.Y. Leg. Doc. No. 65(K) (1946). It is interesting to note that the Law Revision Commission in Leg. Doc. No. 65(K) was not as certain as Mr. Reoux as to the extent of the applicability of this amendment. "It is possible, of course, that the provisions of the 1943 amendment might also be applied to the 'factor's lien' on accounts receivable arising from sale of goods on which the factor has acquired a lien by filing a notice and posting a sign, pursuant to section 45. As against such a construction, it would be argued that the 1943 amendment was added in the separate paragraph dealing with assignments of accounts, and, moreover, speaks of the assignor and assignee." N.Y. Leg. Doc. No. 65(K), p. 161 (1946).

112. "[T]he 1943 amendment merely overcomes the decision in Lee v. State Bank & Trust Co. and declares that the assignee's lien on accounts shall not be invalidated by the assignor's reservation of dominion over tangible property on which the assignee has, actually, no lien." N.Y. Leg. Doc. No. 65(K), p. 161 (1946).

113. When the returned merchandise is resold, any account receivable rising therefrom would normally be reassigned to the factor. "[I]t is the established custom that the factor has a legal title to the net amount of receivables outstanding at any time." Letter From Walter Neal, Treasurer of the Duplan Corp. to Assemblyman Harry A. Reoux, March 10, 1943. This, of course, does not satisfy the Lee rule.

to answer the question raised by Mr. Justice Brandeis in this respect. Where it did answer this question, it answered it in favor of the applicability of the "dominion rule."

### E. *The 1954 Amendment*[114]

In 1954 the legislature discarded the requirement of posting a sign.[115] It was upon this device that the factors had originally relied to maintain their common law lien without having possession of the goods. The sign was also the device the legislature used in 1910 in its abortive attempt to create a constructive possessory lien.[116] It was the requirement of the sign together with the requirement of filing notice that was finally enacted into law in 1911. As time went on, however, creditors began to rely less on the sign and more on the reports of credit agencies that regularly checked the records.[117] Soon the sign became a superfluous nuisance. It no longer informed creditors, but it did inform those who had no need to know, or who had no understanding of the lienee's method of financing. At times it was detrimental to sales, it caused concern among employees of the lienee, and it required the factor to insure that the sign remained posted where the creditors could see it, under penalty of losing his lien.[118] For these reasons the amendment was

114. N.Y. Sess. Laws 1954, ch. 594.

115. Ibid.

116. See notes 50-53 supra and accompanying text.

117. In his Report to the Hon. George Shapiro, Counsel to Governor Dewey, March 25, 1954, Assemblyman Stanley Steingut, who introduced the amendment, stated that the concept of posting a sign "is completely old-fashioned, in that it presupposes that credit grantors make a personal examination of the premises of the credit seeker. As a matter of fact, credit grantors rely upon financial statements and upon credit reports issued by . . . credit agencies [which] promptly report the filing of a public notice under Section 45, just as they do in the recordation of any chattel or real estate mortgage." [Hereinafter cited as Steingut Report.]

118. Committee on State Legislation of the Association of the Bar of the City of New York, Report No. 141 (1954). This report approved the bill stating "it would not be unduly burdensome to require one . . . to ascertain if a notice of lien has been filed, as is done in the case of mortgages." It is interesting to note that the New York State Bar Association disapproved the bill in a memorandum by Alan J. Flattery, Esq. of the Committee on State Legislation, received by Counsel to the Governor on March 30, 1954. The Association argued that this bill "jumps the gun" on the Law Revision Commission's study of the proposed Uniform Commercial Code. "It seems obvious," Mr. Flattery stated, "that, until the Commission concludes its study . . . present law in the Secured Transactions field should not be tampered with unless clearly and obviously necessary. No such necessity appears at the present time regarding the posting of the aforesaid notice of lien." In spite of the State Bar Association's expectations, the Uniform Commercial Code has not yet been adopted in New York. If adopted it would effectively repeal the "dominion rule." See Uniform Commercial Code § 9-205. To give notice of secured claims, filing requirements are imposed. Uniform Commercial Code § 9-302.

adopted.[119] It did not concern the "dominion rule," or its application to liens created under section 45.

### F. *Conclusions from the Legislative History*

A number of points become apparent from the legislative history of section 45. First, the 1911[120] act did not abrogate the "dominion rule," which was firmly established in New York. Second, the relationship between section 45 and the "dominion rule" has not been changed by the amendments of 1931,[121] 1935,[122] or 1954.[123] The 1943 amendment[124] was passed to restrict the rule in *Lee v. State Bank & Trust Co.*,[125] with respect to straight assignments of accounts receivable. In effect it acknowledged the applicability of the "dominion rule" to such assignments. Third, although the "dominion rule" remains applicable to all of section 45, the retention of dominion over returned merchandise will be violative of the rule when the factor has a lien on merchandise, but not when he has a straight assignment of accounts receivable under section 45.

## IV. The Theory of Footnote 11 in the Courts

Because of the factor's justified caution, there is a paucity of cases involving the question raised in footnote 11 to *Benedict v. Ratner*.[126] Whenever it has been raised the courts have had difficulty with it, primarily because they do not seem to have been acquainted with the purposes of the act.

The only holding on this question is found in the New Hampshire decision of *Colbath v. Mechanicks Nat'l Bank*.[127] The New Hampshire Factor's Lien Act[128] was at the time[129] "derived almost verbatim,"[130] from

119. N.Y. Sess. Laws 1954, ch. 594. The amendment also stated "in more general terms the type of indebtedness which may be covered," by adding the words "obligations, indebtedness" to "commissions, charges and expenses." Steingut Report, op. cit. supra note 117. "The addition . . . merely clarifies the broad scope of the statute and follows the language used in certain other states. . . ." New York City Bar Association Report, op. cit. supra note 118.

120. N.Y. Sess. Laws 1911, ch. 326, § 1.

121. N.Y. Sess. Laws 1931, ch. 766.

122. N.Y. Sess. Laws 1935, ch. 690.

123. N.Y. Sess. Laws 1954, ch. 594.

124. N.Y. Sess. Laws 1943, ch. 635.

125. 38 F.2d 45 (2d Cir. 1930). See note 103 supra and accompanying text.

126. 268 U.S. 353, 361 n. 11 (1925).

127. 96 N.H. 110, 70 A.2d 608 (1950).

128. N.H. Rev. Stat. Ann. §§ 446.1-10 (1955) (Supp. 1959).

129. New Hampshire has recently repealed its Factor's Lien Act by adopting the Uniform Commercial Code. N.H. Rev. Stat. Ann. ch. 382-A (1961). This chapter became effective July 1, 1961.

130. Manchester Nat'l Bank v. Roche, 186 F.2d 827, 830 (1st Cir. 1951).

New York's section 45 as amended through 1943. New Hampshire had also adopted the "dominion rule."[131] In *Colbath*, the defendant bank allowed the borrower to sell the goods subject to the lien and use the proceeds without accounting to the bank.[132] The court held, *inter alia*, that the "dominion rule" did not apply to the New Hampshire equivalent of section 45. It disposed of the whole matter in three sentences:

> The answer to this seems to be that there is no provision in Chapter 262-A [the New Hampshire Factor's Lien Act] requiring the borrower to account. Furthermore section 7 of the act demands that it be "construed liberally." It therefore seems that the failure to account did not invalidate the lien.[133]

It is possible that the court was correct in interpreting the New Hampshire Legislature, but that the legislature was wrong in interpreting the New York act which it adopted. Perhaps the New Hampshire Legislature actually intended to abrogate the "dominion rule" and mistakenly thought it could accomplish this by adopting the New York act. If this were the case, the decision in *Colbath* is correct, but it has no application to the law of New York. If, however, the New Hampshire Legislature had the same purpose as the New York Legislature, the decision in *Colbath* is wrong. Assuming this to be so then the two arguments made by the court are easily answerable.

The first sentence, quoted above, begs the question. The court was called upon to decide whether this statute, which does not specifically require accounting, was meant to abrogate the common-law "dominion rule." To say the statute does not specifically require accounting is not very helpful. In any event, the omission of a requirement that the borrower account was due to the fact that the original act was developed to meet specific problems as they arose and not to create new rights, *sub silentio*. This is clear from the legislative history of the New York act.

The second quoted sentence cites language of the statute. It seems apparent that the New York Legislature never intended the "liberal construction" provision to be construed so liberally. The holding, if it is an interpretation of an act similar in purpose to the New York act, is unfortunate and ill considered, and should not be persuasive in New York courts.

131. See Haskins v. Dube, 101 N.H. 224, 138 A.2d 677 (1958).

132. This was in spite of an agreement which provided in part: "this Agreement shall be construed as an assignment by the Borrowers to the Bank of all . . . accounts receivable or other proceeds arising from the sale of the property now or hereafter subject to the lien . . . ." 96 N.H. at 111, 70 A.2d at 609.

133. Id. at 113, 70 A.2d at 610.

In *Manchester Nat'l Bank v. Roche*,[134] a subsequent New Hampshire case in the federal courts, the "dominion rule" was held applicable to an assignment of accounts under the New Hampshire Factor's Lien Act.[135] Judge Magruder noted correctly that the New Hampshire equivalent of the 1943 amendment to New York's section 45, had abolished the rule of *Lee v. State Bank &Trust Co.*[136] with respect to assignments of accounts, and had, by implication, acknowledged the applicability of the "dominion rule" to such assignments. He distinguished *Colbath*, holding it applicable only to liens on merchandise and the proceeds thereof under the New Hampshire Factor's Lien Act. This decision left the New Hampshire law in a state of seeming inconsistency. The "dominion rule" was applicable to assignments of accounts made under the New Hampshire Factor's Lien Act. The "rule," however, was inapplicable to liens on chattels, where it had originally applied, if such liens were established under the same factor's lien act, albeit a different part thereof. The legislature, faced with this dichotomy, decided against the "dominion rule," and brought the accounts receivable section of the act in line with the *Colbath* interpretation of the merchandise and proceeds section.[137] In amending the act in this way, the New Hampshire Legislature followed an enlightened trend away from the "dominion rule." This action, of course, does not affect the question of whether the New York act has abolished the "dominion rule" without such an amendment.

### *New York Decisions*

In New York the problem arose in connection with the second *Bloch v. Mill Factors Corp.* case.[138] In the first *Bloch* case[139] Judge Learned Hand held that a straight assignment of accounts receivable under section 45 did not give the assignee a lien on the returned merchandise even though the agreement so provided because the returned merchandise could not be considered "proceeds" of the assigned accounts. Such a lien on merchandise could be obtained only by filing and posting in accordance with the act. This decision led to the second *Bloch* case where the trustee claimed that the assignor was permitted to exercise dominion over the returned merchandise, thereby invalidating the entire series of assignments under the rule of *Lee v. State Bank & Trust Co.* The factor argued that the rule of *Benedict v. Ratner* had been abrogated

134. 186 F.2d 827 (1st Cir. 1951).
135. N.H. Rev. Stat. Ann. §§ 446.1-10 (1955) (Supp. 1959).
136. 38 F.2d 45 (2d Cir. 1930).
137. N.H. Laws 1951, ch. 218.
138. 134 F.2d 562 (2d Cir. 1943).
139. 119 F.2d 536 (2d Cir. 1941).

by section 45. Thus, the question was put to the court. Unfortunately, however, the court decided the case on another ground, saying, "In our opinion we can decide the case, as did the court below, without considering the effect of the New York statute."[140] The court held that in order to invoke the rule of *Benedict v. Ratner* the assignee must have agreed to the practice of the assignor in exercising dominion over the returned merchandise. Since there was no such agreement here, the court held that the case was outside the *Benedict* principle.[141]

In *Matter of Cut Rate Furniture Co.*,[142] a federal district court in New York came to the brink of deciding the question herein considered. The holding was that no dominion had been reserved by the lienee. However, there was very strong dicta to the effect that section 45 abrogates the "dominion rule."

The case involved a factor's lien on merchandise and the proceeds thereof. The factor allowed the lienee to keep the down payments on merchandise sold on conditional sale. The referee in bankruptcy held the lien invalid because

> the domination of the proceeds of down payments of the sales of inventoried merchandise was so completely in the hands of the lienor [*sic*] as to render the alleged

140. 134 F.2d at 562.

141 Appellee, who maintained that section 45 abrogated the "dominion rule," argued that it was the 1931 amendment that had "overruled" the "dominion rule": first, because the change to affirmative language meant that the act was not just a recording statute but an "enabling act which affirmatively provides for the creation of new rights." Brief for Appellee, p. 31, Bloch v. Mill Factors Corp., 134 F.2d 562 (2d Cir. 1943). See notes 66-72 supra and accompanying text. And second, because the statute specifically provided that it be "construed liberally." Brief for Appellee, Bloch v. Mill Factors Corp., op. cit. supra at 32. See notes 85-89 supra and accompanying text. A brief was submitted on behalf of certain factors as amici curiae, also maintaining that section 45 had abrogated the "dominion rule." They, too, argued that the 1931 amendment was meant to overrule Benedict v. Ratner, but on other grounds. The 1931 amendment was enacted after the Benedict and Lee decisions, they pointed out. It put straight assignments of accounts receivable under the act. This would be a mere restatement of the common law and valueless unless intended to give the assignee a new right he did not have previously. See notes 72-76 supra and accompanying text. This reliance on a maxim of construction was answered by appellant in its reply brief with another maxim of construction—that any derogation of the common law must be clearly expressed. Brief for Appellant, pp. 25-27, Bloch v. Mill Factors Corp., 134 F.2d 562 (2d Cir. 1943). In support of their argument the amici quoted statements from a number of cases, not in point, which seemed to say that section 45 was an extension of prior law. That section 45 extends prior law in many areas (for example, it gives the factor a non-possessory lien) is not contested. Amici further argued that the words of the statute "should be given their face value." Brief for Amici Curiae, p. 8, Bloch v. Mill Factors Corp., 134 F.2d 562 (2d Cir. 1943).

142. 163 F. Supp. 360 (N.D.N.Y. 1958).

factor's lien void under the rule of Benedict v. Ratner. It can hardly be said to be a minor deviation from the contract that could be overlooked.[143]

He thus rejected the factor's contention that section 45 had abrogated the "dominion rule."

The district court reversed the referee on this point, holding that there had been no violation of the "dominion rule."[144] The parties did not purport to include down payments in the factoring agreement and there is nothing in section 45 requiring them to do so. The "dominion rule" requires that the parties live up to the terms of their agreement, and as to the merchandise and accounts receivable which were included within the terms of the agreement there was "nothing approaching 'unfettered dominion.' . . . "[145] The court commented further:

It may be that this Section [section 45] does not allow "unfettered dominion" or free-wheeling with inventory by the person creating the lien, even when its conditions are followed, but such was not the actual fact here.[146]

However, Judge Foley devoted much of his opinion to a discussion of the effect of section 45 on the "dominion rule." He laid great emphasis on a report of Referee (now New York Supreme Court Justice) Sydney A. Fine to the Supreme Court of the State of New York.[147] Judge Foley agrees with, but for the purposes of the opinion finds it

unnecessary to assume completely the broad and well-reasoned conclusion of Referee Fine . . . that Section 45 . . . if properly followed, renders inapplicable the Benedict rule and the companion rule of New York regarding chattel mortgages at least as to the remaining inventory of merchandise.[148]

In his report Referee Fine quoted footnote 11 to *Benedict v. Ratner,* and similar language from an article by Justice Stone.[149] He also cited the *Colbath*[150] case saying:

No contrary authority has been cited by counsel, or uncovered by my independent research. In my opinion, the *Colbath* decision is a sound interpretation of the factor's law, and it is accordingly my conclusion that a validly created factor's lien is not rendered invalid at least as to the remaining inventory, notwithstanding that the borrower is expressly permitted to use the proceeds of sales for his own benefit without accounting therefor to the lienholder.[151]

143. Decision, Findings of Fact, Conclusions of Law and Order of Referee Ryan, No. 37458 (N.D.N.Y. July 29, 1957).

144. Matter of Cut Rate Furniture Co., 163 F. Supp. 360 (N.D.N.Y. 1958).

145. Id. at 365.

146. Ibid.

147. See Report of Referee Sidney A. Fine to the Supreme Court of the State of N.Y. 34-40 (Dec. 12, 1955).

148. 163 F. Supp. at 364.

149. Stone, The "Equitable Mortgage" in New York, 20 Colum. L. Rev. 519 (1920).

150. 96 N.H. 110, 70 A.2d 608 (1950).

151. Report of Referee Fine, op. cit. supra note 147, at 36-37.

Referee Fine conceded that the rule of *Manchester Nat'l Bank v. Roche*[152] may be valid because as to straight assignments of accounts receivable there is no filing requirement. As a result "there may perhaps be sound policy considerations for continuing the *Benedict* rule as respects such assignments."[153] He concluded, however, that

> since, as noted, the question appears to be an open one in this State, I have reached the conclusion, particularly in view of the pronounced trend against the continued dominance of the Benedict doctrine, that that doctrine should not be extended to other situations, such as that here presented, in which its application is not demanded by controlling considerations either in logic or policy.[154]

The last two quotations from Referee Fine's report appear to present a sound basis for consideration by a court deciding on the validity of the "dominion rule." The "rule" is a creation of the courts; they have the power to limit it or to overrule it if the circumstances demanding a change are deemed more compelling than the policy calling for stare decisis. Referee Fine, however, was not deciding on the validity of the "dominion rule." He was interpreting a specific statute, attempting to determine whether it abrogated a common-law rule. In this context, a "pronounced trend," or "sound policy considerations" would seem to be irrelevant.

Besides his reliance on Referee Fine's report, Judge Foley stated that he attached great importance to footnote 11 because "in my judgment Justice Brandeis foresaw the broad scope of Section 45 . . . ."[155] Judge Foley did make reference to legislative purpose, and observed that the legislature had amended the statute several times after certain court decisions; indicating "as expressed in the Statute itself, [an] intent for liberality of construction."[156]

Thus the courts have come close to a holding inconsistent with the legislative intent regarding section 45. It is perhaps better that such a holding has been avoided.

## V. The Theory of Footnote 11 in Practice

The problem raised by footnote 11 will undoubtedly come before the bar again, but, more than likely, the case will not involve a large factoring concern. As noted earlier, factors are naturally cautious. They carefully police liens obtained in connection with section 45, not only to avoid *Benedict v. Ratner*, but because it is essential business practice to do so. One large New York factor admits it is their practice

152. 186 F.2d 827 (1st Cir. 1951).
153. Report of Referee Fine, op. cit. supra note 147, at 38.
154. Id. at 39.
155. 163 F. Supp. at 364.
156. Id. at 365.

(and we suspect that of most other factors and finance companies) to "police" inventory pledged to us under a New York Factor's Lien arrangement, (1) by requiring periodic reports of "ins and outs" of inventory, and (2) by requiring immediate remission in kind of the proceeds of sale of pledged inventory . . . despite our belief that Article [*sic*] 45 . . . [abrogates the "dominion rule"]. . . . The reason we police these loans is our desire to maintain constant knowledge as to the nature and amount of our collateral. Such policing is essentially a matter of good business practice. Indeed, we follow this practice even in states which operate under the Uniform Commercial Code. . . .[157]

While all the factors seem to follow the practice of policing their section 45 liens and assignments, they differ as to treatment of returned merchandise. This appears to be due to a conflict among them as to the meaning and purpose of the 1931 and 1943 amendments to section 45.

It is not unusual for some factors to go further than the statute requires. In some instances, they do not permit the debtor or assignor to have dominion over returned goods even under a straight assignment of accounts receivable.[158] This behavior may seem strange in the light of the strong campaign the factors waged for the 1943 amendment, which abrogated the rule of *Lee v. State Bank & Trust Co.*[159] with respect to straight assignments of accounts receivable. There are two explanations for such conduct. First, the major reason given by the factors for their support of the 1943 amendment was that in spite of their efforts to follow up returns as carefully as possible, they found "that in practice it is impossible to educate the customers to notify . . . [them] when they return goods."[160] The factors were not asking for the right to relax their vigilance; rather they wanted to be sure their lien would not be destroyed in spite of it. Second, the factors still seem worried about the interpretation of the act. There is some question in their minds as to whether the assignment of accounts provision under section 45 is intended as a statutory validation law or applies only where a "notice of lien"

157. Letter From Factor Wishing to Remain Anonymous to Author, March 15, 1960. For an interesting discussion of the business reasons involved in the factors' decision to police their liens, see Note, 101 U. Pa. L. Rev. 392, 393-94 (1952).

158. These factors have explained their position in letters to the author as follows: "We do not permit the . . . assignor to have dominion over returned goods where we do not have a lien on merchandise under Section 45. Our financing agreements require segregation of . . . [returned merchandise]. Actually . . . when merchandise is returned . . . we usually require a substitution of other accounts receivable for the abortive accounts represented by the returned merchandise. Upon receipt of such new accounts receivable, we release the merchandise . . . ." Letter From Factor Wishing to Remain Anonymous to Author, March 15, 1960.

159. 38 F.2d 45 (2d Cir. 1930).

160. See Letter From William H. Stonaker, President of Mill Factors Corp., to Charles D. Breitel, Counsel to Governor Dewey, March 24, 1943.

under section 45 has been filed. The factors fear that if the statute does not apply to straight assignments of accounts where no notice of lien is filed, then a straight assignment without notice filing would not receive the protection of the 1943 amendment which abrogated the *Lee* rule. Such fears appear groundless when one recalls that the 1931 amendment brought straight assignments of accounts within the statute, and did so in order to assure those who dealt in such assignments that the amendment did not abrogate any of their common-law rights to loan money on assignments of accounts receivable without notice to the debtor and without notice filing under the statute. The 1931 amendment was not enacted to impose new requirements on such lenders. Such an analysis would attach to the amendment the exact interpretation it was enacted to prevent. It would seem, therefore, that these anxious factors are more cautious than they legally need be. This results from the fact that when the day of trouble comes, the security is very likely not to be there if the factor doesn't carefully police his debtor, and because the factors have had their fingers burned by the courts too many times.

On the other hand there are some factors who seem to believe that the 1943 amendment abrogated the rule of the *Lee* case, not only with respect to straight assignments of accounts, but also with respect to liens upon accounts which arise from the sale of merchandise subject to the lien. Accordingly, they permit the manufacturer to have dominion over all returned goods.[161] It would seem, in light of the discussion of the 1943 amendment, that where dominion is reserved as to returned goods in connection with a lien on merchandise and its proceeds, the lien would be invalid under the doctrine of *Lee v. State Bank & Trust Co.* In this respect these factors seem to have "thrown caution to the winds," which is completely out of character for them.

## VI. Conclusion

This article was not written as a defense of the "dominion rule." Such a rule may be good business practice, but our free enterprise system has its own inherent penalties for poor businessmen. There is little need for the courts to take it upon themselves to penalize further the man who is not

161. Counsel for one of these factors explained his company's reasons for permitting such dominion as follows: "The New York statute now provides that the permitting of dominion over returned merchandise does not invalidate the lien on the accounts receivable involved or any other accounts assigned to the factor. In the ordinary course of business we do permit our clients to have dominion over returned goods, since it would be an almost impossible task to keep track of every parcel returned . . . . The foregoing presupposes that our client is financially stable and does not apply in situations where the client's financial condition is on the downgrade." Letter From Factor Wishing to Remain Anonymous to Author, March 15, 1960.

prudent enough to police his security. It would seem that as long as creditors are not misled, the security holder should be able to salvage whatever he can from his lien. Creditors would not be misled if the law provided for adequate filing or recording of security instruments.

However, before one can think of modifying the law, it must first be determined what the law is. The purpose of this article was to determine the state of the law with respect to the application of the "dominion rule" to section 45. The conclusion reached is that the "dominion rule" is applicable, and was always meant to be applicable to any lien upon merchandise and its proceeds, or any assignment of accounts receivable under section 45. But the extension of the "dominion rule" in the case of *Lee v. State Bank & Trust Co.* does not apply to assignments of accounts receivable which do not arise from the sale of merchandise subject to the lien.

The above conclusion is compelling in spite of the eminence of the opinions to the contrary and those which consider the question an open one. Such opinions, it is submitted, were made without reference to the legislative history of section 45.