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# THE RETAIL PAPER PURCHASER AND THE PROCEEDS LIEN

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One of the numerous ways by which a retailer may double finance is by accepting a down payment on the conditional sale of an article floor-planned by an inventory financer, transferring the conditional sales contract and note to a financing agency other than his inventory financer, and keeping the proceeds of both transactions without any accounting. The resulting battle between the two financing agencies he could enjoy if not worried as to whether he was to be indicted for his behavior. While, strangely enough, the litigation between two such financers has been somewhat sparse, the cases lack neither dramatic nor legal interest. Can the retailer be considered a pirate of the inventory financer's business? Should the retail financer be protected as the holder of a negotiable specialty? These are some of the questions raised by the problems in this area.[1]

A recent Michigan case, *Dart National Bank v. Mid-West Corporation*,[2] presents the problems in a rather interesting posture. Here the retail financer sought to replevy a house trailer which had been the object of trust receipt financing undertaken by the defendant inventory-financing entruster. Pursuant to a statement properly filed under the Michigan Uniform Trust Receipts Act,[3] a trust receipt was issued, in which the retailer-trustee agreed not to sell the trailer, until full payment was made of the amount due the entruster. In complete disregard of the trust receipt, the retailer sold the trailer under a conditional sales contract to a good faith purchaser who turned in an old trailer as down payment, and gave the usual negotiable note secured by the conditional sales agreement for the balance. The note and agreement were negotiated and assigned to the plaintiff bank under a warranty that the trailer was free of all liens and encumbrances save the interest of the conditional purchaser. On learning of the transaction shortly thereafter, the entruster, who of course had not been paid, talked the purchaser into surrendering the trailer to him and caused the return of the trade-in. In its defense to the replevin action, the entruster contended that the bank acquired no

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[1] See Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057 (1954); Kripke, Chattel Paper as a Negotiable Specialty Under the Uniform Commercial Code, 59 Yale L.J. 1209 (1950).

[2] 356 Mich. 574, 97 N.W.2d 98 (1959).

[3] Mich. Comp. Laws, §§ 551.401-555.419.

interest in the trailer because the retailer had agreed under the trust receipt not to sell the property until the sum secured had been paid, and further because the bank was not a good faith purchaser, it having made no inquiry of the retailer as to whether any liens were outstanding against the trailer. The court disposed of the latter point by finding that such an inquiry, in view of the warranty contained in the contract, would have been fruitless. This was the first transaction between the bank and the retailer, and the bank had no actual knowledge of the existence of the trust receipt transaction.

A major battle ground under the Uniform Trust Receipts Act in inventory-financer versus retail-financer litigation has centered about the applicability of Sections 9 and 10. Section 9 gives a good faith purchaser from the trustee of negotiable or quasi-negotiable instruments,[4] arising out of the conditional sales transaction, rights free of the interest of the entruster, despite complete compliance with the statutory requirement for the filing of the entruster's interest. Section 10 affords to the entruster "to the extent to which and as against all classes of persons as to whom his security interest was valid at the time of disposition by the trustee" the proceeds of goods sold by the trustee other than in compliance with the terms of the trust receipt agreement.[5] Not surprisingly, diverse results have been had in the cases largely dependent upon whether the individual court has read Section 9 or 10 to be controlling. While mathematically more courts seem to have favored protection of the retail rather than the inventory financer, there can hardly be said to be any recognizable majority on either side of the question.[6]

In the present litigation, the court ignored previous Michigan cases dealing with the rights of a financing agency of a dealer who sells in violation of the terms of the financing agreement, decided prior to or apart from the Uniform Trust Receipt Act,[7] and concerned

[4] Section 9(1)(a) deals with the rights of purchasers from a trustee of negotiable instruments and documents as well as of " . . . instruments in such form as are by common practice purchased and sold as if negotiable . . . ." See Gilmore, supra note 1, pages 1102-1107.

[5] This is subject to the limitation that the proceeds must be received by the trustee within ten days of a demand by the entruster for a prompt accounting. Knowledge on the part of the entruster of the existence of proceeds for ten days without demand for an accounting constitutes a waiver by the entruster of his rights in the proceeds.

[6] Skilton, Cars For Sale: Some Comments on the Wholesale Financing of Automobiles, 1957 Wis. L. Rev. 352, 422.

[7] In National Bond & Investment Company v. Union Investment Company, 260 Mich. 307, 244 N.W. 483 (1932), autos covered by a floor mortgage plan were sold. The financer of the conditional sales contract and transferee of the contract and note was held to acquire only the rights of the conditional vendee and to be subject to the interest of the mortgagee.

In the later case of Fidelity Corporation v. Associates Discount Corporation, 340

itself solely with the interpretation of the Act. In so doing, the decision can hardly be said to be helpful. The Court quotes Section 10 only to ignore it; and reaches its conclusion by finding that the note, despite its reference to the conditional sales contract, was negotiable under the NIL and Section 9(1)(a). By Section 9(1)(b) the note is to be considered the equivalent of the trailer entrusted to the retailer. Back to Section 9(1)(a), the note-now-trailer having been taken from the retailer by the bank for value in good faith, it is held free by the bank of the entruster's interest. The same conclusion is then reached by the court with respect to the conditional sales contract. It is an "instrument" as defined by Section 1 of the Act, being a credit instrument; it becomes the equivalent of the trailer under Section 9(1)(b), and by Section 9(1)(a) the conditional sales agreement-now-trailer is held free of the entruster's interest, it having been taken by the bank in the manner customary for instruments which by common practice are purchased and sold as "if negotiable".

While the end result of the decision is not undesirable, and its conclusion probably unassailable in the absence of Section 10, the court has obviously failed to come to grips with the latter section (possibly for the reason that these two sections appear irreconcilable in this context). Consequently the case is something less than satisfactory in view of the decisions which have protected the entruster by recognition of the proceeds lien provided for by Section 10.[8]

The Uniform Commercial Code deals with the subject in Sections 9-306 and 9-308. By the former section a lien is given to the inventory financer on the proceeds of installment sales, the lien encompassing the conditional sales contracts and other "chattel papers". In the hands of the retailer they are subject to the entruster's security

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Mich. 610, 66 N.W.2d 235 (1954), the floor plan mortgage gave the mortgagor-retailer the right to sell for cash or credit terms approved by the mortgagee. The conditional sales contract under which the retailer sold the mortgaged cars was assigned to a financing agency without recourse. No payment having been made by the retailer to the mortgagee, an unsuccessful attempt was made to have the finance company declared a trustee of the receipts of the conditional sales contract. By looking at the "realities of the transaction" the court found the retailer received the same amount of money as if there had been a cash sale, and that it should be treated as the equivalent of a sale for cash. Consequently, the purchaser of the sales contract was protected.

[8] General Motors Acceptance Corporation v. Associates Discount Corporation, 38 N.Y.S.2d 972 (Syracuse Munic. Ct. 1942), rev'd on other grounds, 267 App. Div. 1032, 48 N.Y.S.2d 242 (4th Dep't 1944); Canandaigua National Bank & Trust Company v. Commercial Credit Corporation, 135 N.Y.S.2d 66 (4th Dep't 1954), reversing 204 Misc. 946, 126 N.Y.S.2d 376 (Sup. Ct. 1953). For a variation of the problem of the nature of the entruster's interest under Section 10 see In re Harpeth Motors, Inc., 135 F. Supp. 863 (D.C. Tenn. 1955).

rights. By Section 9-308, however, the financer of the conditional sales agreement who purchases the retail paper from the trustee by giving "new value" for it is protected as against the original inventory financer, with respect to the note (which is presumably in negotiable form) whether he has knowledge of the entruster's security interest or not if he takes in the ordinary course of business, and with respect to any non-negotiable instruments only if he has a lack of knowledge of the entruster's outstanding interest, and in addition takes in the ordinary course of business. Both sections having been extremely carefully drafted with full cognizance of the difficulties of interpretation experienced under the Uniform Trust Receipts Act, and both sections having been completely re-written in 1957, it is anticipated that the major problems of interpretation have been eliminated. Under these sections the result reached in *Dart National Bank v. Mid-West Corporation* has been preserved.