

# THE OHIO UNIFORM TRUST RECEIPTS ACT

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The Ohio Uniform Trust Receipts Act<sup>1</sup> became effective on August 30, 1957. The act, with only two material changes,<sup>2</sup> embodies the text of the Uniform Trust Receipts Act adopted by the National Conference of Commissioners on Uniform State Laws in 1933. At the present time the Uniform Trust Receipts Act is in effect in thirty-two states and Hawaii and Puerto Rico.<sup>3</sup>

It is the belief of the writers, based in large part on their own intellectual condition until some months ago, that Ohio practitioners are not very familiar with the mechanics and effect of the Uniform Trust Receipts Act. The provisions of the UTRA are, unfortunately, quite complicated, often unclear, and sometimes almost meaningless unless read in the light of the history and purposes of the act. One purpose of this article will accordingly be to attempt to explain the provisions of the act.<sup>4</sup> Other purposes, equally important, will be to assess the extent to which the UTRA changes prior Ohio law and to discuss the impact of the UTRA on other related Ohio statutes presently in effect.

The Uniform Trust Receipts Act, of course, derives its name from the subject of most of its provisions—financing by means of trust receipts. The provisions of the act with respect to trust receipt financing were primarily intended to make available a procedure for secured financing in connection with the following two types of transactions:

- (1) The acquisition of new inventory for manufacture, sale and related short-term purposes.

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<sup>1</sup> OHIO REV. CODE §§ 1316.01-.31 (Baldwin 1958). The Uniform Trust Receipts Act is sometimes referred to in this article as the UTRA.

<sup>2</sup> In addition to these two changes which will be noted later, the Ohio act omits section 18 of the Uniform Act which provides that the act shall be construed in the light of its purpose "to make uniform the law of the states which enact it."

<sup>3</sup> The UTRA was formerly in effect in Massachusetts and Pennsylvania, but was repealed when those states adopted the Uniform Commercial Code.

<sup>4</sup> Several excellent articles deal with the provisions and purposes of UTRA. Bacon, *A Trust Receipts Transaction*, 5 FORDHAM L. REV. 17, 240 (1936); Bogert, *The Effect of the Trust Receipts Act*, 3 U. CHI. L. REV. 26 (1935); Heindl, *Trust Receipt Financing Under the Uniform Trust Receipts Act*, 26 CHI-KENT L. REV. 197 (1948). Selected problems under the UTRA are treated in Rohr, *Some Problems in Trust Receipt Financing*, 3 WAYNE L. REV. 22 (1956).

The present article will not consider the treatment under the Uniform Commercial Code of the problems dealt with by the UTRA. This subject is considered in Rudolph, *Judicial Construction of the Trust Receipts Act and its Reflection in the Commercial Code*, 19 U. PITT. L. REV. 1 (1957).

- (2) The release of pledged commercial paper for various short-term purposes.

(Lest the foregoing be taken to be a comprehensive summary of the act's coverage, it should be noted at once that the act sometimes authorizes or appears to authorize trust receipt financing in connection with transactions not related to the avowed purposes of the drafters.) The most notable feature distinguishing trust receipt financing under the UTRA from financing by means of chattel mortgages or conditional sales is the act's provisions for valid chattel security interests without filing in connection with transactions completed within thirty days and its provision for simple "notice" filing (similar to that employed under the Ohio Assignment of Accounts Receivable Act<sup>5</sup>) in connection with transactions completed after a longer period. The drafters of the UTRA believed that such provisions were justified for two reasons by the fact that trust receipts transactions were limited to new acquisitions of property and surrender of pledged property both for short-term purposes:

- (1) The transactions contemplated by the Act involved a rapid turnover of collateral and would be greatly impeded by a requirement of filing a series of papers specifically identifying such collateral.
- (2) Since the collateral in the transactions contemplated by the Act would be in the possession of the debtor only for short periods there would be little opportunity for reliance by other creditors on the debtor's apparent ownership and hence little need for recording of the type required under the chattel mortgage statutes.<sup>6</sup>

Another feature of the UTRA strongly distinguishing it from chattel mortgage or conditional sale acts is its provisions specifically setting forth the rights of the secured party to the proceeds of the property subject to the security interest.

Although the UTRA was drafted primarily to deal with trust receipt transactions, certain sections of the act provide for a security device which is in some instances quite unrelated to the trust receipts transaction, namely, pledges without change of possession.<sup>7</sup>

#### HISTORY OF TRUST RECEIPT FINANCING IN OHIO

Before proceeding to an analysis of the provisions of the Ohio Uniform Trust Receipts Act, a brief consideration of the status of trust receipts in Ohio before the adoption of the act may afford some historical perspective often useful in understanding the act's provisions.

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<sup>5</sup> OHIO REV. CODE §§ 1325.01-.08 (Baldwin 1958).

<sup>6</sup> Report of Committee on UTRA, 1933 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS 244.

<sup>7</sup> OHIO REV. CODE §§ 1316.07-.09 (Baldwin 1958).

To a great number of Ohio's practicing lawyers the trust receipt is a brand-new and foreign breed of security device. Therefore, it should be helpful before proceeding further to set forth at this point the following clear and concise explanation of the pure<sup>8</sup> trust receipt which appears in Ohio Jurisprudence:

This is a tripartite arrangement between the seller, the buyer, and the financing agency. A buyer wishes to buy (usually from a distant seller) goods for manufacture or sale. A party willing to finance the purchase pays the distant seller or guarantees payment and takes title to the goods as security. In due time the goods are put into the possession of the buyer and the financing agency takes back trust receipts. By virtue of the trust receipt contract, the buyer is given limited authority over the goods, usually to manufacture and/or sell, and holds the goods and, upon their sale, the proceeds, in trust for the financing agency. The financing agency retains, by agreement, the title for security purposes and the right to repossess itself of the goods in their present or altered form, or to seize the proceeds derived through the sale of the product.<sup>9</sup>

The pure trust receipt is truly sui generis among security devices. Its distinguishing characteristics are (1) involvement of three parties: seller, buyer (trustee) and lender (entruster); (2) title to the goods passing directly from the seller to the entruster; (3) right of the entruster to retake possession of the goods at any time not conditioned on the default of the trustee and (4) duty of the trustee to account to the entruster for the proceeds of sale.

The evolution of the trust receipt began with the import trade where it became the subject of extensive use. Consequently the trust receipt became fairly well recognized as a legitimate security device by the courts of the seaboard states. With the tremendous growth of the automobile industry, finance companies turned to the trust receipt for the purpose of creating a security interest in the cars which they financed for the dealer on a wholesale basis. Use of the trust receipt then spread into other areas of the domestic economy.<sup>10</sup> To the inland courts, however, the trust receipt was a stranger looked upon with suspicion and hostility. In their desire to strike out against the evil of the secret lien, the judges insisted upon shoving this square peg into the well-established round holes

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<sup>8</sup> *I.e.*, the traditional common law concept of the trust receipt.

<sup>9</sup> OHIO JUR. 1016 (1934). In 1954 the editors of OHIO JUR.2d used the exact same definition of trust receipt and almost the same treatment of the subject. See 9 OHIO JUR.2d *Conditional Sales and Trust Receipts* § 40 at 647. This is not surprising because in the twenty-year interval the Ohio law of trust receipt financing stood absolutely still without a single legislative or judicial development.

<sup>10</sup> 9C UNIFORM LAWS ANN., *Uniform Trust Receipts Act, Commissioners' Prefatory Note* 221 (1957).

provided for chattel mortgages and conditional sales. The result was "as hopeless and divided a set of authorities as one can expect to find."<sup>11</sup>

The Ohio cases are typical. All were decided by the Sixth Circuit Court of Appeals in bankruptcy situations. The earliest decision is *In re Bettman-Johnson Co.*<sup>12</sup> decided in 1918. The plaintiff was seeking to enforce his rights in imported cherries, and the proceeds thereof, which were a part of the bankrupt's estate. A pure trust receipt transaction was involved. The bankrupt had arranged for the importation of cherries from Italy to Cincinnati, Ohio. The purchase price was advanced to the seller by the plaintiff and the cherries were shipped to the plaintiff with the bill of lading to its order. Upon receipt of the cherries they were turned over to the bankrupt upon the execution and delivery by it to the plaintiff of a trust receipt which provided that the borrower was to hold the goods in trust for the lender, the borrower was to turn over all proceeds of sale thereof to the lender and the lender was to be able to resume possession of the goods at any time. The trust receipt was neither verified nor recorded. It was held by the court that the plaintiff's security interest was invalid due to the failure to comply with the statutory formalities and filing requirements for conditional sales contracts. The court had difficulty in finding the elements of a conditional sale but, relying upon the broad language of the conditional sales law,<sup>13</sup> found that "it is at least so far in the nature of a conditional sale as to fall within the terms of the Ohio statute."<sup>14</sup>

If the unrecorded pure trust receipt transaction in the *Bettman-Johnson* case was condemned, it was only to be expected that an unrecorded two-party trust receipt would be held invalid a fortiori. Thus, the court in *Commerce-Guardian Trust & Savings Bank v. Devlin*<sup>15</sup> had no difficulty in knocking out the lender's security interest where the bankrupt had borrowed money from a bank and had secured the loan by the delivery to the bank of bills of sale conveying title to automobiles, the possession of which was retained by the bankrupt pursuant to "trust receipts" executed in favor of the bank. In reaching its decision the court cited both the Ohio chattel mortgage and conditional sales statutes.<sup>16</sup>

At this point of history, the Ohio General Assembly made an abortive attempt to rescue the beleaguered trust receipt from its judicial assailants. The conditional sales statute was amended, effective July 11, 1925, to exempt from the necessity of filing as a conditional sales contract or chattel mortgage "trust receipts or similar instruments" and to provide a method for perfecting such security interests against creditors

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<sup>11</sup> *Ibid.*

<sup>12</sup> 250 Fed. 657 (6th Cir. 1918).

<sup>13</sup> OHIO GEN. CODE §§ 8568 (Throckmorton 1948), OHIO REV. CODE § 1319.11 (Baldwin 1958).

<sup>14</sup> Note 12, *supra* at 663.

<sup>15</sup> 6 F.2d 518 (6th Cir. 1925).

<sup>16</sup> *Id.* at 519.

of the trustee and all persons claiming under the trustee except purchasers and mortgagees in good faith and for value.

The bill's draftsman in providing for a simple notice filing exhibited a modern approach to commercial financing which was far ahead of the times. All that was required to be filed of record was an affidavit setting forth the names and addresses of the parties, the fact that the signer had arranged for financing by the issuance of a trust receipt to the lender and describing in general terms the goods to be covered. The notice was required to be filed prior<sup>17</sup> to the delivery of the trust receipt and continued effective for a period of three years.

The statute covered only the pure tripartite trust receipt, it being limited to trust receipts issued to a person—

who . . . has paid, or has become obligated to pay . . . the purchase price of . . . goods . . . and who holds the title . . . to secure the repayment of the amounts so paid or assumed, and who, upon the faith of such trust receipt . . . delivers to the signer thereof the possession of such . . . goods . . . with the agreement that such signer shall hold such goods . . . in trust . . . with liberty . . . to sell or manufacture the same, but only for the account of the holder of such trust receipt, and that the signer shall immediately pay over to such holder all proceeds of such property, if sold, such holder to have the right at any time to repossess . . . said goods. . . .

But for a self-imposed freakish limitation upon its applicability, this statute would probably have enjoyed extensive use and acceptance as a respected member within the family of recognized security devices. For some inexplicable reason, the legislature restricted the law to trust receipts for (A) goods imported from without the United States, or from Puerto Rico, the Philippine Islands, or the Hawaiian Islands, and (B) "a readily marketable staple, wherever purchased." The error of limiting the scope of the law by the use of this last unfamiliar phrase was compounded by defining it in the following highly restrictive manner:

a readily marketable staple is an article of commerce, agriculture, or industry, of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make the price easily and definitely ascertainable and the staple itself easy to realize upon by sale at any time.

The commodities which conceivably could have fit within this definition such as steel, ore, coal or grain are about the most unlikely

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<sup>17</sup> Cf. Assignment of Accounts Receivable Act, OHIO REV. CODE § 1325.03 (Baldwin 1958).

things that one can imagine as the subject of extensive secured financing. Conversely, in the only case decided under the trust receipt provision of Ohio Gen. Code section 8568, it was held that automobiles (the item of personal property which is the subject of the greatest number of security transactions and which introduced the trust receipt to domestic use) were not "readily marketable staples."<sup>18</sup> The court found that it was the intention of the legislature to limit strictly the coverage of the trust receipt act to the two designated classes and not to remove the barrier as to all trust receipts in common use. Relying upon the "settled law in Ohio" that a trust receipt, when given as security for payment of a debt, must be characterized as a chattel mortgage or conditional sales contract, the court held that the lender's security interest in automobiles was invalid as a result of the failure to file for record under such laws.<sup>19</sup>

Thus, the Ohio trust receipts law of 1925, covering only the strict tripartite transaction and being severely limited in its scope, became a dead letter which gathered dust until its repeal, effective August 30, 1957, provided for as a part of the bill enacting the Ohio Uniform Trust Receipts Act.<sup>20</sup>

It is ironic that a decade following the enactment of the 1925 trust receipts law, the Commissioners of Uniform Laws expressly acknowledged that they had conceived the idea of notice filing, which is incorporated as a cornerstone of the Uniform Trust Receipts Act, from the Ohio law.<sup>21</sup>

The last Ohio decision to consider the validity of a trust receipt was *In re Collinwood Motor Sales, Inc.*<sup>22</sup> There the credit company entruster had recorded the trust receipt covering an automobile as a conditional sales contract. Consistent with its previous decisions, the court decided that the petition for reclamation of the automobile from the estate of the bankrupt automobile dealer was well founded since proper record notice of the lien had been given to third parties.

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<sup>18</sup> *Central Acceptance Corp. v. Lynch*, 58 F.2d 915 (6th Cir. 1932).

<sup>19</sup> Illustrative of the inconsistency of the results reached by the courts in determining the validity of trust receipts under the laws of the various states are two companion decisions of the *Lynch* case handed down by the 6th Circuit Court of Appeals on the same day. In *Commercial Investment Trust Corp. v. Wilson*, 58 F.2d 910 (6th Cir. 1932), a trust receipt was held to be a mortgage under Kentucky law which was invalid against creditors where unrecorded, while in *Hamilton Nat. Bank v. McCollum*, 58 F.2d 912 (6th Cir. 1932) an unrecorded trust receipt was upheld under Tennessee law as against the debtor's trustee in bankruptcy.

<sup>20</sup> Because the trust receipt notices under the 1925 law were filed and indexed with chattel mortgages, the writers were unable to learn how many notices were filed but clerks with long experience in the Recorder's Office who were consulted reported that such notices were few and far between.

<sup>21</sup> See *Commissioner's Prefatory Note*, *supra* note 10, at 223.

<sup>22</sup> 72 F.2d 137 (6th Cir. 1934).

## THE PROVISIONS OF OHIO UNIFORM TRUST RECEIPTS ACT

*Property Which May Be The Subject Of A Trust Receipt*

The major weakness of the original Ohio trust receipts law, as has already been pointed out, was the limitation of property coverable by trust receipts to imported goods and "readily marketable staples." The Ohio Uniform Trust Receipts Act authorizes the use of trust receipts in connection with much broader classes of property, namely, "goods, documents or instruments."<sup>23</sup>

The most important class of property covered by the UTRA judging from the volume of reported cases from other jurisdictions which are devoted thereto is "goods," which is defined in the Ohio act to include any chattels personal other than money, choses in action, fixtures or motor vehicles.<sup>24</sup> In excepting motor vehicles from its coverage, the Ohio act departs from the original text of the Uniform Act. It is somewhat paradoxical that motor vehicles, which were the first important subject of domestic trust receipts financing, have been outside the coverage of two successive Ohio trust receipts statutes, in the first case as a result of narrow judicial construction and now as a result of a specific statutory provision. The reason for the exclusion of motor vehicles from the coverage of the Ohio act was presumably the possibility of conflict between the provisions of the act favoring "buyers in the ordinary course of trade" over holders of perfected security interests and the apparently contrary provisions of the Ohio Certificate of Motor Vehicle Title Law.<sup>25</sup>

The second class of property is "documents," which term is defined to mean documents of title to goods.<sup>26</sup> Documents of title would presumably include bills of lading, warehouse receipts, dock warrants or receipts, delivery orders and like documents customarily treated in business or financing as evidencing title to goods.

The third class of property which may be the subject of a trust receipts transaction is "instruments," which term is defined to exclude "documents" and to include: (1) negotiable instruments; (2) certificates of stock, bonds or debentures for the payment of money issued by a public or private corporation as part of a series; (3) "any interim deposit, or participation certificate or receipt, or other credit or investment instrument of a sort marketed in the ordinary course of business or finance, of which the trustee, after the trust receipt transaction, appears by virtue of possession and the face of the instrument to be the owner."<sup>27</sup> The most uncertain portion of the definition of "instruments" is that

<sup>23</sup> OHIO REV. CODE § 1316.02 (Baldwin 1958).

<sup>24</sup> OHIO REV. CODE § 1316.01(D) (Baldwin 1958).

<sup>25</sup> OHIO REV. CODE § 4505.04 (Baldwin 1958). *But see* OHIO REV. CODE § 4505.13 (Baldwin 1958).

<sup>26</sup> OHIO REV. CODE § 1316.01(B) (Baldwin 1958).

<sup>27</sup> OHIO REV. CODE § 1316.01(E) (Baldwin 1958).

which has been italicized. The following questions present themselves in connection with the underlined phrase: Is the word "other" to be limited by the application of the rule of *ejusdem generis*? What is a "credit or investment instrument"? When is an instrument "marketed in the ordinary course of business or finance"? Reported decisions have not shed much light on the interpretation of this phrase. As a practical matter, probably, very few trust receipt transactions would have as their subjects instruments lying in this uncertain zone. However, as will be pointed out later, the inadequacy of the definition of "instruments" has been made quite apparent by litigation concerning the rights to proceeds of goods covered by trust receipts.<sup>28</sup>

#### *Parties To A Trust Receipt Transaction*

*The parties to a trust receipt transaction under the UTRA must stand in a pure creditor-debtor relation.* The creditor party is referred to in the act as the "entruster" of the property which is the subject of the transaction and the debtor party as the "trustee" of such property.<sup>29</sup> However, as will later appear, the types of transactions between debtor and creditor which are within the coverage of the act are narrowly and complexly delimited.

Conditional sale transactions and other similar transactions between vendor and vendee are expressly excluded from the coverage of the act by section 1316.01(C) which excludes from the definition of "entruster"

a person in the business of selling goods or instruments for profit, who at the outset of the transaction has, as against the buyer, general property in such goods or instruments, and who sells the same to the buyer on credit, retaining title or other security interest under a purchase money mortgage or conditional sales contract or otherwise. . . .

Section 1316.29 also excludes from the coverage of the act bailments or consignments "in which the title of the bailor or consignor is not retained to secure an indebtedness of the bailee or consignee."

#### *Prerequisites Of A Valid Trust Receipt Transaction*

To comprehend the area of operation of the UTRA it is necessary to master not only the express exclusions of the act, but the complex provisions of the act affirmatively setting forth the prerequisites of a valid trust receipts transaction. One court has said of the act:

To avoid trespassing upon the traditional and well-defined fields of such common security devices as the pledge, conditional sale and chattel mortgage, most of the Act is devoted to

<sup>28</sup> See pp. 715-16 *infra*.

<sup>29</sup> OHIO REV. CODE §§ 1316.01(C), (N) (Baldwin 1958).

definition, limitation and restriction of the arena in which the new device is to play its part in the world of commerce.<sup>30</sup>

(1) *Purposes of trust receipt transactions.*

In determining whether a transaction may be financed by trust receipts under the act the purpose of the transaction is a decisive factor.

Section 1316.02 provides that a transaction in order to constitute a trust receipt transaction under the act *must have as its purpose one of the purposes set forth in section 1316.06.*

Section 1316.06 provides that in the case of goods, documents or instruments, the purpose may be their sale or exchange; in the case of goods or documents, the purpose may be to manufacture or process the goods delivered or covered by the documents with the purpose of ultimate sale, or to transport, store and otherwise deal with such goods "in a manner preliminary to or necessary to their sale"; in the case of instruments, the purpose may be delivery to a principal, depositary or registrar, or their presentation, collection, or renewal.

(2) *New value.*

The act requires that the entruster give the trustee "new value" in order to obtain a valid security interest under the act. "New value" is defined in section 1316.01(G) as follows:

"New value" includes new advances or loans made, new obligation incurred, the release or surrender of a valid security interest, or the release of a claim to proceeds under Section 1316.20 of the Revised Code; but "new value" shall not be construed to include extensions or renewals of existing obligations of the trustee, nor obligations substituted for such existing obligations.

To be contrasted with this definition is the act's definition of "value" in section 1316.01(O):

"Value" means any consideration sufficient to support a simple contract. An antecedent or pre-existing claim, whether for money or not, and whether against the transferor or against another person, constitutes value where goods, documents or instruments are taken either in satisfaction thereof or as security therefor.

It will be noted that although an antecedent indebtedness may constitute "value," it is not included in the definition of "new value" and may even be said to be excluded impliedly by the reference to "new" advances, loans or obligations.

The requirement of "new value" for valid trust receipt transactions

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<sup>30</sup> *In re Chappell*, 77 F. Supp. 573, 575 (D. Ore. 1948).

was apparently inserted in the act on the theory that a creditor giving new value had a stronger claim to the major benefits of the act, *i.e.*, short-term protection without filing, and long-term protection by "notice" filing, than creditors not giving new value.<sup>31</sup> However, this distinction between "new" and other value seems contrary to the trend of modern commercial statutory law which is to give antecedent indebtedness equal status as value with the more traditional types of consideration.

In none of the other Ohio statutes governing commercial transactions<sup>32</sup> do we find the concept of two kinds of value which may be given by a secured party with different consequences flowing from the giving of each. Rather, in contradistinction to the UTRA, in most of these laws an antecedent debt is specifically included within the meaning of "value." The statutes referred to include the Negotiable Instruments Law,<sup>33</sup> Factors' Lien Act,<sup>34</sup> Uniform Sales Act,<sup>35</sup> Chattel Mortgage Law,<sup>36</sup> Uniform Warehouse Receipts Act,<sup>37</sup> Assignment of Accounts Receivable Act<sup>38</sup> and Uniform Stock Transfer Act.<sup>39</sup>

Judicial resistance to the special status given to new value under the UTRA seems evidenced by cases which, although perhaps capable of narrower readings on the basis of the factual situations presented, appear to hold broadly that satisfaction of an antecedent debt constitutes "new

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<sup>31</sup> The distinction between "new value" and "value" is also significant under the provisions of the UTRA dealing with the protection of purchasers from the trustee and those dealing with imperfect pledges. See pp. 701-05 and 717 *infra*.

<sup>32</sup> See OHIO REV. CODE title XIII (Baldwin 1958).

<sup>33</sup> OHIO REV. CODE §§ 1301.01(M), .27 (Baldwin 1958).

<sup>34</sup> OHIO REV. CODE §§ 1311.59-64 (Baldwin 1958). This act contains no reference to "value" and no definition of "loans or advances" which is the analogous phrase used. It might be argued on the basis of certain language in the act that an antecedent loan or advance would not be protected. See OHIO REV. CODE § 1311.61(C) (Baldwin 1958).

<sup>35</sup> OHIO REV. CODE § 1315.01(U) (Baldwin 1958).

<sup>36</sup> OHIO REV. CODE § 1319.01 (Baldwin 1958). The statute does not cover the subject of value or consideration, but the sparse Ohio authority on the subject indicates that a chattel mortgage given in consideration of an antecedent debt will be upheld as against subsequent creditors. 27 OHIO JUR. *Mortgages* § 56 (1933); *Mussey v. Budd*, 11 Ohio C.C. 550 (Lorain county 1896); *Noble County Bank v. Dondna*, 7 Ohio Dec. Rep. 532 (Guernsey Dist. Ct. 1878). However, a chattel mortgage given as security for a pre-existing debt does not constitute the taker a mortgagee in good faith or a bona fide purchaser so as to allow him to prevail over the holder of a prior unfilled chattel mortgage. 9 OHIO JUR.2d *Chattel Mortgages* §§ 57, 97 (1954). The very nature of a conditional sale, the essential feature of which is reservation of title in the vendor, eliminates any problem relative to the value necessary to support the security interest. Unless filed for record as required by OHIO REV. CODE § 1319.11 (Baldwin 1958), a conditional sale is void as to "all subsequent purchasers and mortgagees in good faith and for value, and creditors." It is likely that a court would hold, as in the case of a chattel mortgage, that "value" as thus used would not include a pre-existing indebtedness.

<sup>37</sup> OHIO REV. CODE § 1323.01(L) (Baldwin 1958).

<sup>38</sup> OHIO REV. CODE § 1325.01(L) (Baldwin 1958).

<sup>39</sup> OHIO REV. CODE § 1705.01(I) (Baldwin 1958).

value" under the act.<sup>40</sup> This result seems plainly inconsistent with the distinction made by the act in the definitions of "new value" and "value." However, an attempt was made, in the cases referred to, to reconcile these two definitions by reading the definition of "new value" as not exclusive. In support of this position it was pointed out, quite correctly, that the definition of "new value" does not literally include a cash payment for goods, although such payment is clearly new value. Nevertheless, it is a substantial jump from an omission of an obvious kind of "new value" to the conclusion that the clear distinction between the definitions of "new value" and "value" may be ignored. It would, therefore, be unwise to rely on the possibility that the cases referred to would be followed in Ohio.

(3) *Transactions covered.*

The primary division between the types of trust receipt transactions authorized by the act is between those authorized by section 1316.02(A) and those authorized by section 1316.02(B). The primary differences between transactions authorized by these two subsections are as follows:

1. Section 1316.02(A) applies to transactions involving goods, documents or instruments. Section 1316.02(B) applies only to transactions involving instruments.
2. Section 1316.02(A) requires a *delivery* of property to the trustee. Section 1316.02(B) requires, instead of delivery, the *exhibition* of instruments by the trustee to the entruster.

With these distinctions in mind a closer look may be taken at the provisions of section 1316.02(A) and section 1316.02(B).

As has been noted section 1316.02(A) requires a *delivery* of goods, documents or instruments. The act abolishes the common-law rule that a trust receipt's validity depends on the passage of title to the entruster directly from a third person rather than through the trustee by providing in section 1316.02(A) that delivery of goods, documents or instruments may be made to the trustee by the entruster or *any third person* and by providing in section 1316.03: "The security interest of the entruster may be derived *from the trustee* or from any other person, and by pledge or by transfer of title or otherwise."<sup>41</sup>

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<sup>40</sup> Colonial Fin. Co. v. DeBenigno, 125 Conn. 626, 7 A.2d 841 (1939); Commercial Discount Co. v. Mehne, 42 Cal. App. 2d 220, 108 P.2d 735 (1st Dist. 1940).

<sup>41</sup> However, it must be pointed out that in following the orthodox pattern of obtaining title directly from a third party, who would in the most common case be a manufacturer of goods, the entruster can easily satisfy himself that there are no title problems relating to the entrusted property. If, on the other hand, the entruster obtains his security indirectly through the trustee, he must check carefully as to whether the trustee has obtained full and unclouded title from the third parties. Some entrusters have found themselves with invalid security interests because of defects in the trustees' title; the cases hold that third parties delivering property

Section 1316.02(A) covers transactions involving delivery of goods, documents, and instruments in which the entruster (1) prior to the transaction had a security interest or (2) for new value either by the transaction obtains or as a result of the transaction is to acquire promptly a security interest.

The first type of transaction covered by section 1316.02(A) would embrace the delivery by the entruster of goods, documents or instruments in which he already has a security interest, such as a pledge interest, and the substitution of a trust receipt for the earlier security interest. The application of this provision to transactions in instruments should be stressed. For example, under this provision, a bank holding negotiable instruments as collateral for a loan may release them as they mature and return them to the pledgor for collection or renewal, receiving from the pledgor a trust receipt covering the released instruments. Similarly, a bank holding stocks or bonds as security for a loan to a broker may release them to the broker for sale, taking a trust receipt. However, it should be recognized before entering such a transaction or *any* trust receipt transaction that a pledge is a stronger security interest than a trust receipt in view of the power of a trustee in possession to pass good title to buyers in the ordinary course of trade and good faith purchasers of negotiable instruments and documents. Indeed, for this reason the UTRA has been said to provide protection only against the "honest insolvency" of the trustee.<sup>42</sup>

The second type of transaction covered by section 1316.02(A) is a transaction involving a delivery of goods, instruments, or documents in which the entruster had no security interest prior to the transaction but in which he obtains such an interest by the transaction or promptly thereafter as a result of the transaction. Except for transactions of the type described in the previous paragraph, the requirement of a transaction involving delivery and of the obtaining of a security interest by the entruster if not precisely contemporaneously with the transaction then promptly thereafter limits the availability of section 1316.02(A) to *new* acquisitions of property.<sup>43</sup> Several cases have held invalid trust receipts executed a considerable period after the trustee's acquisition of the prop-

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into the possession of the trustee with liberty of sale are not by reason of such delivery estopped to assert their interests in the entrusted property against the entruster. *E.g.*, *Ford Motor Co. v. National Bond and Inv. Co.*, 294 Ill. App. 585, 14 N.E.2d 306 (1st Dist. 1938); *In re San Clemente Elec. Supply*, 101 F. Supp. 252 (S.D. Cal. 1951); *Metropolitan Fin. Corp. v. Morf*, 42 Cal. App. 2d 756, 109 P.2d 969 (2d Dist. 1941).

<sup>42</sup> Report of Committee on Uniform Trust Receipts Act, 1933 HANDBOOK OF THE NATIONAL COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS 241.

<sup>43</sup> In some cases OHIO REV. CODE § 1316.02(A) (Baldwin 1958) would apparently be applicable, although no new acquisition is involved and the entruster had no security interest prior to the transaction. The section would appear to apply where A, who has property on pledge with B, obtains a loan from C by means of which he obtains the release of the property from pledge.

erty covered thereby.<sup>44</sup> The limitation of this section of the act to financing of new acquisitions cannot be too highly stressed. One of the most common and most dangerous misconceptions of the act is that the trust receipt device is available whenever a chattel mortgage would be available.

Section 1316.02(B) includes in the definition of trust receipt transactions, transactions whereby "the entruster gives new value in reliance upon the transfer by the trustee to such entruster of a security interest in instruments which are actually exhibited to such entruster, or to his agent in that behalf, at a place of business of either entruster or agent, but possession of which is retained by the trustee." Under this section a lender giving new value can obtain a valid security interest by way of trust receipt in a negotiable instrument or other "instrument" as defined by the act if the instrument is exhibited to the lender and is retained by the borrower for a purpose listed in section 1316.06. However, as has already been noted, in many cases the lender, unless he has considerable confidence in the honesty of the borrower, would do better to secure his loan by way of pledge.

Section 1316.28 explicitly spells out a limitation on the scope of the act which is probably implicit in the detailed provisions discussed above, namely, that as against purchasers and creditors the entruster's security interest extends:

- (1) to any obligations for which the entrusted property was security before the trust receipt transaction, and
- (2) to any new value given or agreed to be given as part of such transaction;

but does not otherwise secure

- (1) past indebtedness of the trustee, or
- (2) obligations of the trustee to be subsequently created.

These limitations on the act's coverage severely restrict the usefulness of the act as a device for obtaining a floating charge on inventory.

(4) *Requirement of writing.*

A further prerequisite to a valid trust receipts transaction, set forth in section 1316.02(C), is that the delivery of goods, instruments or documents under section 1316.02(A) or the giving of new value in reliance on the exhibition of instruments under section 1316.02(B) must

- (1) Be against the signing and delivery by the trustee of a writing designating the goods, documents, or instruments

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<sup>44</sup>*In re* San Clemente Elec. Supply, 101 F. Supp. 252 (S.D. Cal. 1951); *In re* Chappell, 77 F. Supp. 573 (D. Ore. 1948); *B-W Acceptance Corp. v. Benjamin T. Crump Co.*, 199 Va. 606, 99 S.E.2d 606 (1957).

concerned, and reciting that a security interest remains in or will remain in, or has passed to or will pass, to the entruster; or  
(2) Be pursuant to a prior or concurrent written and signed agreement of the trustee to give such a writing.

If the parties execute neither the writing referred to in section 1316.02(C)(1) nor a contract to give such a writing, provided for in section 1316.02(C)(2), their transaction is not within the coverage of the act.<sup>45</sup> The writing referred to in section 1316.02(C)(1) is identified as a "trust receipt" in section 1316.05. This latter section provides that a trust receipt must be signed by the trustee, but provides that no further formality of execution or authentication shall be necessary to the validity of the trust receipt.<sup>46</sup>

The most common provisions of a trust receipt would be the following:

1. *A "designation" of the property entrusted.*<sup>47</sup> This provision is required by section 1316.02(C)(1). The act does not define the degree of particularity with which such identification has been made, but one case has held that, in the absence of precedents under the UTRA, analogies should be sought in decisions with respect to the sufficiency of identification of property in chattel mortgages.<sup>48</sup>

2. *An acknowledgment that the property covered by the trust receipt is held by the trustee in trust for the entruster.* This provision is required under section 1316.02(C)(1) requiring the recital that a security interest remains in, or will remain in, or has passed to, or will pass to, the entruster.

3. *A statement of the purpose or purposes for which the property has been entrusted.* Such purpose or purposes should, of course, be among those listed in section 1316.06 with respect to the type of property covered by the trust receipt.

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<sup>45</sup> Associates Discount Corp. v. C. E. Fay Co., 307 Mass. 577, 30 N.E.2d 876 (1940).

<sup>46</sup> A trust receipt is commonly accompanied by the promissory note of the trustee. The contention that the contemporaneous execution of notes and trust receipts invalidates the trust receipts by reason of inconsistency with a "trust relationship" has been rejected. *Chichester v. Commercial Credit Co.*, 37 Cal. App. 2d 439, 449, 99 P.2d 1083 (2d Dist. 1940). The act explicitly states no "trust," in the strict sense of that term, is created by a trust receipts transaction. OHIO REV. CODE § 1316.01(N) (Baldwin 1958).

<sup>47</sup> The protection of a trust receipt covering certain property extends to other property received by the trustee as trade-ins for the entrusted property, and no new trust receipts need be executed to cover the trade-ins; the "trade-ins" constitute "proceeds" of the entrusted property. See p. 714 *et seq. infra*. However, the protection of a trust receipt covering property will not embrace other property which the entruster and trustee may agree to *substitute* for the originally entrusted property, even if the substituted property is of the same general kind and value of that for which it was substituted. *In re Yost*, 107 F. Supp. 432 (D. Md. 1952).

<sup>48</sup> *In re Nickulas*, 117 F. Supp. 590 (D. Md. 1954), *aff'd sub nom.* *Tatelbaum v. Refrigeration Discount Corp.*, 212 F.2d 877 (4th Cir. 1954).

4. *A provision that the entrusted property is held by the trustee at its sole risk and is to be insured by the trustee.*<sup>49</sup>

5. *A provision requiring the trustee to pay all taxes, expenses or charges imposed or incurred with respect to the entrusted property.*

6. *Provisions setting forth the terms on which the entruster may repossess the entrusted goods.* No limit is imposed by the act on the power of the entruster to fix in the trust receipts the conditions under which repossession may be had. Section 1316.12 provides that the entruster is entitled, as against the trustee, to possession of the entrusted property "on default, and as may be otherwise specified in the trust receipt."

7. *If the trustee is granted liberty of sale or other disposition, a provision requiring the trustee to segregate and account for proceeds of such sale or disposition.* If the trustee has liberty of sale or other disposition and is not required to account for proceeds, the entruster does not enjoy the rights to such proceeds set forth in section 1316.20.

8. *Limitations on the terms of sale or disposition, such as limitations on the terms of sale or disposition or requirement of the written consent of the entruster prior to sale or disposition, may be desired.* However, no such limitations will be binding upon a buyer in the ordinary course of trade in the absence of "actual knowledge" on his part of such limitations.<sup>50</sup>

Section 1316.02 does not clearly indicate at what point in a trust receipts transaction a trust receipt must be executed. Where property is delivered to the trustee, the safest course is to execute the trust receipt simultaneously with the delivery of the property. However, some cases would seem to indicate that so long as the execution is close in time and relation to the transaction involving delivery or exhibition the precise sequence of events may not be crucial. Thus in one case the validity of a trust receipt has been upheld although executed at a time when title to the entrusted property clearly was in neither the entruster nor the trustee but in the manufacturer.<sup>51</sup> In this case, promptly after the execution of the trust receipt the entruster forwarded it to the manufacturer in order that the manufacturer might fill in a description of the entrusted property. At the same time the entruster paid the full purchase price, whereupon the manufacturer issued a bill of sale to the entruster and shipped the goods to the buyer.

Section 1316.02(C) provides that a trust receipt transaction may also be valid if the delivery under section 1316.02(A) or the giving of

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<sup>49</sup> When such insurance is obtained, the existence of the entruster's interest should, of course, be disclosed to the insurance company and the policy should explicitly provide for protection of such interest. See *Keating v. Universal Underwriters Ins. Co.*, 320 P.2d 351 (Mont. 1958).

<sup>50</sup> OHIO REV. CODE §§ 1316.18(A)(2), 1316.01(A) (Baldwin 1958).

<sup>51</sup> *Walton v. Commercial Credit Co.*, 68 S.D. 151, 299 N.W. 300 (1941). *But cf. Metropolitan Fin. Corp. v. Morf*, 42 Cal. App. 2d 756, 109 P.2d 969 (2d Dist. 1941).

new value, under section 1316.02(B) is "pursuant to a prior or concurrent written and signed agreement of the trustee to give . . . [a trust receipt]." It has been held that since an agreement to give a trust receipt is not a recordable document, no particular form is required for such an agreement and the question whether a paper or papers constitute such an agreement is a mere question of contract law.<sup>52</sup> Does the execution of an agreement to give a trust receipt dispense with any requirement that a trust receipt eventually be executed? Section 1316.02(B) does not answer this question. However, section 1316.10 provides that

A contract to give a trust receipt, if in writing and signed by the trustee, is, with reference to goods, documents or instruments *thereafter delivered by the entruster to the trustee* in reliance on such contract, equivalent to a trust receipt. (Emphasis added.)

This section would indicate that only in the orthodox trust receipts transaction recognized at common law, *i.e.*, where property is delivered to the trustee by the entruster and not directly from a third person does the execution of a contract to give a trust receipt dispense with a requirement that a trust receipt be eventually given in connection with the trust receipts transaction. Moreover, not even all such orthodox trust receipt transactions are covered, but only such transactions which involve delivery *subsequent* to the execution of the agreement. Obviously, an eventual giving of a trust receipt would be required in all transactions under section 1316.02(B) since no delivery is involved in such transactions.

There would be a substantial advantage in having a contract to give a series of trust receipts fully equivalent to such trust receipts if the parties might by entering such contract avoid the necessity of having to execute, each time new collateral was taken, separate trust receipts which would identify such collateral. However, it is doubtful whether great advantage in this regard is given by the act even in the case of delivery of property by an entruster to a trustee. In the first place, it appears that an agreement in order to constitute a "contract to give a trust receipt" would have to identify the property to be covered thereby with the same specificity as would be required in a trust receipt. Furthermore, the requirement of section 1316.02(A) that the entruster "promptly" obtain a security interest would seem to limit the period for which the signing of a contract to give a trust receipt might avoid the necessity of executing separate trust receipts or entering into a new contract.<sup>53</sup>

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<sup>52</sup> In the matter of *Le Vee and Co.*, 252 F.2d 214 (7th Cir. 1958).

<sup>53</sup> See *Rohr*, *supra* note 4.

Section 1316.11 provides that a contract to give a trust receipt if in writing and signed by the trustee is specifically enforceable against the trustee with respect to property subsequently delivered by the entruster to trustee. It should be noted that this provision is also literally limited to certain orthodox common-law trust receipts transactions. In any event, its usefulness is doubtful, since a contract to give a trust receipt in connection with such a transaction is deemed equivalent to a trust receipt.

(5) *Filing*

A further prerequisite to the validity of a trust receipt transaction against persons not parties thereto is, under most circumstances, the filing of a financing statement. These filing requirements will be discussed in more detail later.

*Rights and Obligations of Parties  
to a Trust Receipt Transaction*

Section 1316.12 provides that as between the entruster and trustee the terms of a trust receipt are, except as otherwise provided in the act, valid and enforceable.<sup>54</sup> However, section 1316.12 specifically provides that no provision for forfeiture of the trustee's interest shall be valid except as provided in section 1316.13(E). The latter section authorizes provisions for such forfeiture, against cancellation of the trustee's indebtedness,<sup>55</sup> as to "articles manufactured by style or model." One commentator has suggested that this term should not be construed to include automobiles.<sup>56</sup> This provision is apparently based on the premise that values of articles manufactured by style or model are unstable. Since it is likely that upon the default of the trustee of such goods, their value will have shrunk to the point of wiping out the trustee's interest, it is reasonable to allow the entruster to extinguish such interest without the formalities of sale. Moreover, in light of the riskiness of trust receipt transactions in goods of unstable value, it is not unconscionable that the entruster should be permitted to have an opportunity to recoup his losses on some transactions in such goods with gains from forfeitures on others.

Section 1316.13(A), as already noted, provides that the entruster is

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<sup>54</sup> It is likely, however, that the courts will follow the well settled Ohio rule applicable in other areas of the law and refuse to enforce a provision for the payment of the entruster's attorney's fee by the trustee upon the latter's default. Stipulations for payment of attorney's fees have been held to be void as against public policy where contained in: a promissory note, *Miller v. Kyle*, 85 Ohio St. 186, 97 N.E. 372 (1911); a chattel mortgage, *In re Chadwick*, 140 Fed. 674 (N.D. Ohio 1905); a lease, *Midwest Properties Co. v. Renkel*, 38 Ohio App. 503, 176 N.E. 665 (1930); and a trade association contract, *List v. Burley Tobacco Growers' Co-op. Ass'n.*, 22 Ohio Law Rep. 455 (Brown County Ct. App. 1924).

<sup>55</sup> It is provided that "in the case of the original maturity of such an indebtedness there must be cancelled not less than eighty per cent of the purchase price to the trustee, or of the original indebtedness, whichever is greater; or, in the case of a first renewal, not less than seventy per cent, or, in the case of a second or further renewal, not less than sixty per cent."

<sup>56</sup> Bacon, *supra* note 4, at 267.

entitled, as against the trustee, to possession of entrusted property on default and as may be otherwise specified in the trust receipt. An entruster entitled to possession on default or in accordance with the terms of a trust receipt may, under section 1316.13(B), take possession without legal process whenever such repossession is possible without a breach of the peace.

An entruster who has repossessed property subject to a trust receipt holds such property with the rights and duties of a pledgee,<sup>57</sup> except that he is granted certain rights of sale under section 1316.13(C)(2) if repossession has been taken by reason of a default of the trustee to sell such property. It is unclear whether the term "default" should be taken to refer to a default in payment of indebtedness or whether it embraces any default in the performance of any obligations under the trust receipt. In view of the fact that the act imposes no limit on the obligations which may be imposed under a trust receipt, the former interpretation may be preferable.

Section 1316.13(C)(2) provides that an entruster who has taken possession of entrusted property on default may, after not less than five days' written notice to the trustee, sell such property at public or private sale. At a public sale the entruster may become a purchaser. A purchase by an entruster at a private sale is a nullity.<sup>58</sup> The proceeds of a sale by the entruster are to be applied first to the payment of expenses of sale, next to the expenses of retaking, keeping and storing the property, and then to the satisfaction of the trustee's indebtedness. The trustee is to receive any surplus and is liable for any deficiency.

Under section 1316.13(D) an agreement reached by the entruster and trustee *after default* whereby the trustee's interest is forfeited is valid. However, as has already been noted, an agreement reached by the entruster and trustee *before default* providing for forfeiture of the trustee's interest on default would be invalid, except to the extent expressly permitted by the act with relation to "articles manufactured by style or model."

#### VALIDITY OF TRUST RECEIPT TRANSACTION AGAINST THIRD PARTIES

The following sections will consider the validity against third parties of the entruster's interest in the entrusted property. The subject of the entruster's rights in proceeds of the entrusted property will be treated separately.

A key section of the act with respect to the validity of the entruster's interest against third parties is section 1316.14, which deals with the general effect as against third persons of the entruster's filing or

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<sup>57</sup> *Automobile Banking Corp. v. Weicht*, 160 Pa. Super. 422, 51 A.2d 409 (1947).

<sup>58</sup> *In re Car Leasing of America, Inc.*, 109 F. Supp. 642 (S.D. Cal. 1953), *modified on other grounds*, 218 F.2d 549 (9th Cir. 1954).

taking possession. Section 1316.14(A)(1) establishes the general rule that filing by the entruster within the thirty-day period designated in section 1316.15(A)(1) "shall be effective to preserve his security interest in *documents or goods* against all persons," except as otherwise provided in certain enumerated sections. A clear implication of this section appears to be that filing is ineffective to preserve a security interest in instruments. The thirty-day period referred to is the period during which the entruster is protected against certain third parties without a requirement of filing or possession. Section 1316.15(A)(1) provides that in the case of transactions involving delivery, this period commences with delivery. Section 1316.15(A)(2) provides that in the case of transactions involving exhibition of instruments, the period runs from the time of such exhibition or of giving new value in connection with the transaction, whichever is earlier. Hereinafter, this period will be referred to for convenience as "the thirty-day period."

The reason why maximum protection against third parties is obtained by filing within the thirty-day period is made more clear by section 1316.14(A)(2), which provides that filing after the period is valid, but shall be deemed to be created as of the time of such filing *without relation back*. By reason of the absence of relation back entrusters filing after the thirty-day period run the risk of subordination to certain intervening rights.

Section 1316.14(B) sets forth the general rule that the taking of possession by the entruster, so long as retained, has the effect of filing in the case of *goods or documents*, and of notice of the entruster's security interest to all persons, in the case of *instruments*. The distinction made here between goods or documents and instruments supports the implication of section 1316.14(A)(1) that filing in the case of instruments is ineffective to preserve the entruster's rights. It suggests that the only method whereby the entruster can perfect his interest in instruments to the fullest extent is by taking possession on or before the expiration of the thirty-day period. The taking of possession after such period would apparently perfect the entruster's lien prospectively. Decided cases shed no light on this question.<sup>59</sup>

### (1) *Validity Against Creditors*

Section 1316.15(A)(1) provides that an entruster's security interest on goods, documents or instruments is valid *without filing* against "all creditors of the trustee, with or without notice," for the thirty-day period, and thereafter except as otherwise provided.

The term "all creditors" includes "lien creditors." The latter term is defined to mean any creditors who have acquired a specific lien on en-

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<sup>59</sup> One commentator has suggested as a reason for the inapplicability of filing provisions to instruments the fact that "the entruster, by making appropriate notations upon such paper, can bring his security interest to the attention of any third party intending to deal therewith." Heindl, *supra* note 4, at 262, n. 62.

trusted property by attachment, levy, or by any other similar operation of law or judicial process, "including a distraining landlord."<sup>60</sup> The reference to a "distraining landlord," contained in the original draft of the Uniform Act is inappropriate in the Ohio version since in Ohio a landlord does not have the right of distraint by operation of law.<sup>61</sup> The term "lien creditor" does not include any pledgee, mortgagee or other claimant of a security interest created by contract, which persons are defined and treated as "purchasers" rather than "creditors."<sup>62</sup>

The UTRA is the only statute on the books in Ohio expressly allowing a secured party to withhold the filing of notice of his security interest for any length of time during which he is nevertheless protected against lien creditors. The Assignment of Accounts Receivable Act<sup>63</sup> requires that the notice be filed prior to or contemporaneously with the taking of the assignment.<sup>64</sup> The Factor's Lien Act<sup>65</sup> provides that the lien is perfected and valid from the time of filing the notice.<sup>66</sup> A chattel mortgage, when not accompanied by an immediate delivery of possession of the chattels to the mortgagee, must be filed "forthwith" or be void as against creditors, subsequent purchasers and mortgagees in good faith.<sup>67</sup> This last requirement of filing has been construed to mean that the mortgage is effective whenever it is filed as against all creditors of the mortgagor except those creditors who have secured a lien on the chattels by levy or attachment prior to filing.<sup>68</sup> The statute governing conditional sales specifies no time limit within which the contract must be filed in order to gain protection for the vendor<sup>69</sup> but the courts in interpreting the conditional sales law have reached exactly the same result as with respect to chattel mortgages; the conditional vendor's interest will be upheld as against all creditors regardless of when he files the instrument, except creditors who have obtained liens against the property prior to such filing.<sup>70</sup>

Section 1316.15(B) provides that the "entruster's security interest is void as against lien creditors who become such *after such thirty-day period without notice* of such interest and *before filing.*" (Emphasis added.) It should be noted that under section 1316.14, already dis-

<sup>60</sup> OHIO REV. CODE § 1316.01(F) (Baldwin 1958).

<sup>61</sup> 24 OHIO JUR. *Landlord and Tenant* §§ 382, 389 (1932).

<sup>62</sup> OHIO REV. CODE § 1316.01(K) (Baldwin 1958).

<sup>63</sup> OHIO REV. CODE § 1325.01 *et seq.* (Baldwin 1958).

<sup>64</sup> OHIO REV. CODE § 1325.03 (Baldwin 1958).

<sup>65</sup> OHIO REV. CODE § 1311.59 *et seq.* (Baldwin 1958).

<sup>66</sup> OHIO REV. CODE § 1311.60 (Baldwin 1958). It is required under OHIO REV. CODE § 1311.61 (Baldwin 1958) that the notice of lien shall be filed within 15 days after the execution of the written agreement between the factor and the borrower providing for the creation of the lien, but this would seem to be merely a further condition to the perfecting of the lien.

<sup>67</sup> OHIO REV. CODE § 1319.01 (Baldwin 1958).

<sup>68</sup> 9 OHIO JUR.2d *Chattel Mortgages* §§ 47, 55 (1954).

<sup>69</sup> OHIO REV. CODE § 1319.11 (Baldwin 1958).

<sup>70</sup> 9 OHIO JUR.2d *Conditional Sales* §§ 17, 21 (1954).

cussed, it appears that filing does not give an entruster of instruments protection against lien creditors.

A lien creditor, in the absence of contrary provision in the act, "becomes such" within the meaning of section 1316.15(B) when his lien attaches. However, section 1316.15(B)(1) makes contrary provision with respect to the most important case, namely, a levy on, or attachment of *goods*. This section provides that where a creditor secures the issuance of process which within a reasonable time after issuance results in attachment or levy on the goods, he is deemed to have become a lien creditor as of the date of issuance of process. This provision marks a departure from the general Ohio rule which is that a creditor's lien attaches if and when a valid levy is made on the property, which event occurs when the levying officer takes possession thereof.<sup>71</sup> The propriety of departing from this rule in the narrow context of trust receipt transactions while allowing the rule to stand in other situations is highly questionable.

Section 1316.15(B)(2) provides that "unless prior to the acquisition of notice by all creditors filing has occurred or possession has been taken by the entruster" an assignee for benefit of creditors from the time of the assignment, a receiver in equity from the time of his appointment, and a trustee in bankruptcy or insolvency from the filing of the petition has the status of a lien creditor without notice, regardless of the state of his own personal knowledge. The intent of this provision, which is not a model of clarity, is apparently that the various creditors' representatives prevail over the entruster if (1) the appointment, assignment, or petition filing, as the case may be, occurs after the thirty-day period and before the entruster files or takes possession, and (2) at least one creditor had no notice of the entruster's security interest.<sup>72</sup>

The reference to the status of the trustee in bankruptcy, of course, is ineffective since the matter of his status is a question of federal law. However, since the 1950 amendments to the Bankruptcy Act the trustee in bankruptcy has had the status of a lien creditor.<sup>73</sup>

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<sup>71</sup> *In re Estate of Kerns*, 90 Ohio App. 1, 103 N.E.2d 7 (1950). OHIO REV. CODE § 2329.10 (Baldwin 1958) provides that when two or more writs of execution against the same debtor are delivered to the officer on the same day, no preference is given either and such creditors share the property in proportion to their claims, but that in all other cases the writ of execution first delivered to the officer shall be first satisfied.

<sup>72</sup> The section literally makes the time prior to filing or taking of possession by the entruster the relevant time for determining whether all creditors had notice of the entruster's interest. It would seem, however, that the relevant time should be the date of appointment of a receiver, assignment for benefit of creditors, or filing of an insolvency petition. Cf. UNIFORM COMMERCIAL CODE § 9-301(3) (1957 Official Text).

<sup>73</sup> See pp. 706-07 *infra*.

OHIO REV. CODE § 1316.21 (Baldwin 1958) provides that, irrespective of filing, the entruster's and the trustee's interest in entrusted goods shall be subject to "specific liens arising out of contractual acts of the trustee with reference to

(2) *Validity Against Purchasers Of  
Negotiable Documents Or Instruments*

Section 1316.16 provides that the entruster is not protected, whether within the thirty-day period or after and regardless of filing, as against the following classes of persons: (1) purchasers in good faith and for value of negotiable instruments or negotiable documents and (2) purchasers taking from the trustee for value, in good faith, and by transfer in the customary manner "instruments in such form as are by common practice purchased and sold as if negotiable," excluding from both classes, however, transferees in bulk.

It should be noted that, in the case of negotiable instruments and documents, freedom from the entruster's rights is given not only to "holders" of such instruments or documents but to all "purchasers in good faith." "Purchasers" under the act include persons taking by sale, conditional sale, lease, mortgage, pledge or other transfer of a contractual security interest, including a subsequent entruster.<sup>74</sup> The UTRA's broad protection of purchasers of negotiable instruments and documents is in accord with the liberal rules governing the rights of the bona fide purchasers of negotiable instruments, negotiable documents of title and stock certificates under the Negotiable Instruments Law, Uniform Warehouse Receipts Act and Uniform Stock Transfer Act.

The meaning of the phrase "instruments in such form as are by common practice purchased and sold as if negotiable" is unclear, and has been the subject of considerable litigation with respect to the entruster's rights to proceeds.<sup>75</sup>

It has been noted that transferees in bulk are excepted from the provisions of section 1316.16. It would accordingly appear, under section 1316.14(A)(1), that an entruster could prevail over a transferee in bulk with respect to documents by filing within the thirty-day period. The inapplicability of the filing provisions to transactions in instruments has already been noted.

Section 1316.17 establishes the general rule applicable to both trust receipt and imperfect pledge transactions that where goods, documents or instruments are made the subject of a security transaction under the act, and thereafter the trustee procures any documents or instruments in substitution therefor or as proceeds thereof which the trustee there-

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the processing, warehousing, shipping or otherwise dealing with specific goods in the usual course of the trustee's business preparatory to their sale. . . ." It would appear that although the liens covered by this section must arise out of "contractual acts" of the trustee such liens themselves may be contractual, or non-contractual, *e.g.*, artisans' or warehousemen's liens.

OHIO REV. CODE § 1316.21 (Baldwin 1958) does not obligate the entruster personally for any debt secured by a lien within its coverage, and expressly excludes from its coverage landlords' liens.

<sup>74</sup> OHIO REV. CODE § 1316.01(J), (K) (Baldwin 1958).

<sup>75</sup> See pp. 715-16 *infra*.

upon negotiates<sup>76</sup> to a purchaser in good faith and for value, that purchaser receives the same protection as he would have received had the instruments or documents purchased by him been the original subject of the security transaction. For example, A entrusts goods to B, and B sells them to C in return for C's negotiable promissory note. B negotiates C's note to D, a purchaser in good faith and for value. D is protected under section 1316.16 just as he would have been had C's note been the subject of the trust receipt transaction between A and B.

(3) *Validity Against "Buyers In The Ordinary Course Of Trade"*

Section 1316.18(A)(1) provides that where a trustee of goods (1) has liberty of sale and (2) sells to a "buyer in the ordinary course of trade," the buyer takes free of the entruster's interest, both during or after the thirty-day period and whether or not the entruster has filed.

The freedom of the buyer in the ordinary course of trade from the entruster's security interest is one of the most important features of the UTRA. The ultimate purpose of the trust receipts transaction in goods is usually to enable the trustee to sell the entrusted goods and to satisfy his indebtedness to the entruster out of the proceeds. The act's grant of protection to the buyer in the ordinary course of trade facilitates the sale of entrusted goods and is accordingly consistent with the purpose of trust receipts financing.

The "buyer in the ordinary course of the trade" provisions are limited to the case of purchasers of goods. Moreover, the phrase "in the ordinary course of trade" quite clearly excludes purchasers in bulk from protection under these provisions. It should not be concluded, however, that all non-bulk purchasers of goods under all circumstances take free of the entruster's interest. In order to determine under what circumstances a non-bulk purchaser is protected, a closer look must be taken at the two requirements on which protection depends: (a) The trustee must have "liberty of sale" (b) The purchaser must be a "buyer in the ordinary course of trade."

(a) *"Liberty of sale"*

A buyer in the ordinary course of trade is protected only if the entruster has conferred upon the trustee "liberty of sale." This requirement is based upon the premise that the buyer is entitled to protection only if the entruster has authorized the trustee to sell the entrusted goods or taken some action which would indicate to buyers that the trustee had authority to sell. The term "liberty of sale" includes not only the granting of actual authority but is extended to incorporate the so-called "floor-plan" doctrine which had evolved under general estoppel principles prior to the drafting of the UTRA. This doctrine provided

<sup>76</sup> The word "negotiates" might suggest that this section is limited to negotiable instruments or documents. However, it would appear that this section embraces any instruments or documents which would be within the scope of OHIO REV. CODE § 1316.16 (Baldwin 1958).

that a bona fide purchaser of goods subject to a recorded security interest took free of the constructive notice ordinarily provided by recording where the secured party had consented to the placing of the goods on a sales floor. The act follows this doctrine by providing, in section 1316.18(C), that "if the entruster consents to the placing of goods subject to a trust receipt transaction in the trustee's stock in trade or in his sales or exhibition rooms, or allows such goods to be so placed or kept, such consent or allowance shall have like effect as granting the trustee liberty of sale." The scope of this section is quite broad; it has been held that consent to the placing of goods in the trustee's stockroom or warehouse conferred liberty of sale, since the section is not limited to consent to placing of goods on sales floors but includes consent to the placing of goods "in the trustee's stock in trade."<sup>77</sup>

The effect of the existence of "liberty of sale" is that the entruster cannot defeat a "buyer in the ordinary course of trade" either by virtue of the provisions of the UTRA with respect to the thirty-day period or by filing. However, as will be noted, the entruster can prevail, even if the trustee had "liberty of sale," by showing that the purchaser in question had *actual* knowledge of limitations on the trustee's liberty of sale.

(b) "*Buyer in the ordinary course of trade*"

This term is defined<sup>78</sup> to mean a person to whom (1) goods are sold and *delivered* (2) for new value and who (3) acts "in good faith and without actual knowledge of any limitation on the trustee's liberty of sale," including one who takes by conditional sale under a pre-existing contract with the trustee to buy the goods delivered, or like goods for cash or on credit. (4) The term does not include a pledgee, mortgagee or lienor. (5) The term expressly excludes "transferees in bulk."

It should not be concluded that a purchaser to be a "buyer in the ordinary course of trade" must be a retail buyer; a dealer may be a buyer in the ordinary course of trade.<sup>79</sup> A person lending money to a trustee and securing his loan by a mortgage on entrusted property is not a "buyer in the ordinary course of trade," since that term excludes mortgagees. Nor is a finance company within the statutory definition of buyer in the ordinary course of trade if it has received for new value

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<sup>77</sup> Commercial Discount Co. v. Mehne, 42 Cal. App. 2d 220, 108 P.2d 735 (1st Dist. 1940).

<sup>78</sup> OHIO REV. CODE § 1316.01(A) (Baldwin 1958).

<sup>79</sup> Colonial Fin. Co. v. DeBenigno, 125 Conn. 626, 7 A.2d 841 (1939); General Fin. Corp. v. Krause Motor Sales, 302 Ill. App. 210, 23 N.E.2d 781 (1st Dist. 1939); Commercial Credit Corp. v. General Contract Corp., 223 Miss. 774, 79 So. 2d 257 (1955). The court in *DeBenigno* ruled inapplicable to the interpretation of the scope of the term "buyer in the ordinary course of trade" the Ohio case of Colonial Fin. Co. v. McCrate, 60 Ohio App. 68, 19 N.E.2d 527 (Putnam County Ct. App. 1938) which held that the "floor plan" doctrine did not cover sales to a retail dealer.

a note and chattel mortgage given by a third person to the trustee as payment for entrusted goods. This is because the goods were not sold or delivered to the finance company.<sup>80</sup> However, two California cases have held that where the retail purchaser from the trustee arranges his own financing in advance of the purchase and the lender takes an assignment of a conditional sale contract from the trustee the lender has the status of a buyer in the ordinary course of trade.<sup>81</sup> This result is apparently reached on the ground that the lender derives his rights from the retail purchaser of the entrusted property, who himself had the status of a buyer in the ordinary course of trade.

The requirement that a purchaser to become a buyer in the ordinary course of trade must take delivery of the goods should not be overlooked. This requirement is obviously designed to exclude fictitious sales from the coverage of section 1316.18(A).

It should also be noted that a purchaser to be a buyer in the ordinary course of trade must give "new value" (and at the same time the erosion of this term, referred to earlier, should be kept in mind). A sale on credit involves the giving of "new value."

The most fruitful source of litigation under section 1316.18(A) is the question as to whether the purchaser has acted "in good faith and without actual knowledge of any limitation on the trustee's liberty of sale." This phrase must be harmonized with the provisions of section 1316.18(C) which provides that consent to the placing of goods in the trustee's stock in trade confers liberty of sale. Where such consent is given and "liberty of sale" accordingly results it might well be asked how there can be any "limitation" on liberty of sale of which the buyer can have actual knowledge. However, it was apparently the intent of the drafters that where consent to the placing of goods in the stock in trade is given the entruster cannot rely on constructive notice from filing but can prevail if he shows that the buyer had actual knowledge of the existence of trust receipts which restrict the trustee's liberty of sale.<sup>82</sup> It has been held that for the buyer to have such actual knowledge he must have actual knowledge (or perhaps reason to have actual knowledge) that the specific goods which he purchases are subject to trust receipts re-

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<sup>80</sup> B.C.S. Corp. v. Colonial Discount Co., 169 Misc. 711, 8 N.Y.S.2d 65 (City Ct. New York 1938).

<sup>81</sup> Security-First Nat'l Bank of Los Angeles v. Taylor, 123 Cal. App. 2d 380, 266 P.2d 914 (2d Dist. 1954); Bank of America Nat'l Trust & Sav. Ass'n v. National Funding Corp., 45 Cal. App. 2d 320, 114 P.2d 49 (4th Dist. 1941). The result in these cases is questionable but may be defended by comparing them to the case where a buyer in the ordinary course of trade arranges his own financing and gives a chattel mortgage directly to the lender. In the latter case the lender clearly derives his rights from the buyer in the ordinary course of trade and prevails over the entruster.

<sup>82</sup> If the trust receipts do not by their terms limit the trustee's liberty of sale, the trustee can pass good title to a buyer in the ordinary course of trade even if the buyer knows that such trust receipts exist. The important point is whether the buyer knows of any limitations on the trustee's liberty of sale.

stricting the trustee's liberty of sale; mere knowledge on the part of the buyer that the vendor has engaged in trust receipts financing does not amount to bad faith or actual knowledge.<sup>83</sup>

Section 1316.19 provides that the purchase of entrusted *goods, instruments or documents* on credit shall constitute new value, but that the entruster is entitled to any debt owing to the trustee and any security therefor by reason of such credit purchase. It also provides that the entruster's right to such indebtedness shall be subject to any set-off or defense valid against the trustee which accrued before the purchaser has actual notice of the entruster's interest.

Under section 1316.22 it is provided that the entruster shall not be responsible as principal or as vendor under any sale or contract of sale made by the trustee. This section recognizes that since the entruster has only a security interest in the entrusted property rather than active ownership he should have no liability on any sales warranties or agreements made by the trustee.

(4) *Validity Against Purchasers Of Goods Other Than Buyers  
In Ordinary Course Of Trade*

The treatment of purchasers of goods other than buyers in the ordinary course of trade, set forth in section 1316.18(B), seems unduly complicated, and the policies underlying the treatment are not clear. As already noted, the term "purchasers," under the act, means not only persons taking by purchase, in the ordinary sense, but also pledgees, mortgagees and other claimants of contractual security interests. Section 1316.18(B) distinguishes in treatment between (1) a transferee in bulk, defined to mean a mortgagee or pledgee or buyer of the trustee's business substantially as a whole and (2) all other "purchasers" of goods other than buyers in the ordinary course of trade.

Within the thirty-day period, any purchaser *except a transferee in bulk* prevails over the entruster if he (1) gives new value without notice during such period, and (2) *takes delivery of goods before the entruster files*. A transferee in bulk giving value, whether new or not, within the thirty-day period cannot prevail over the entruster.

Any purchaser of goods, including a transferee in bulk, prevails over the period if (1) he gives value (not limited to "new value") *after the thirty-day period* and (2) *takes delivery of the entrusted goods before the trustee files*.

The UTRA's requirement of delivery, as noted above, applies irrespective of whether the subsequent secured party advanced his consideration during or subsequent to the thirty-day period. This requirement of delivery, as applied to the claimant of a contractual security interest, results in much weaker protection than that afforded subsequent secured parties in similar circumstances under other Ohio laws. Clearly, under the laws governing chattel mortgages, conditional sales and

<sup>83</sup> Colonial Fin. Co. v. DeBenigno, *supra* note 79.

factors' liens in Ohio, there is no such requirement of possession imposed upon a subsequent bona fide secured party in order to permit him to prevail over a prior unfiled security interest.

It seems highly unreasonable to require a mortgagee, for example, who had no notice, actual or constructive, of an outstanding trust receipt, not only to file but also to take possession of the goods in order to gain protection as against the entruster. The provision appears all the more unfair when it is considered that the essence of a security transaction by way of mortgage is to permit the debtor to retain possession, that the chattel mortgage statute requires filing in lieu of taking possession and that it is quite likely the mortgagee under the terms of the mortgage will not even have the right to deprive the mortgagor of possession so long as the latter is not in default. As a practical matter, therefore, the protection conferred upon "purchasers" is more or less limited to pledgees who can be expected ordinarily to obtain delivery of pledged property.

#### (5) *Validity In Bankruptcy*

Prior to the 1950 amendment of section 60 of the Bankruptcy Act,<sup>84</sup> a transfer of property was not deemed made, for the purpose of determining whether such transfer was preferential, until such time as such transfer became perfected under state law against both lien creditors and bona fide purchasers for value. If such transfer never became so perfected it was deemed made on the eve of bankruptcy. In the case of *In re Harvey Distributing Co.*,<sup>85</sup> decided in 1950, the effectiveness of secured financing under the Uniform Trust Receipts Act was dealt a severe blow by a holding that since the entruster's interest, in the absence of the taking of possession, could never become perfected against buyers in the ordinary course of trade it must, under the "bona fide purchaser" test of section 60 of the Bankruptcy Act, be deemed to have been conveyed on the eve of bankruptcy and to constitute a preferential transfer. The threat posed to trust receipts financing by such an interpretation of section 60, and not, as is commonly believed, the earlier decisions applying the "bona fide purchaser" test of section 60 to invalidate non-notification as well as notification accounts receivable financing transactions, provided the main impetus to the 1950 amendment of section 60 to replace the "bona fide purchaser" test, in the case of transfers of personal property, with a "lien creditor" test, which is set forth as follows:

For the purposes of [sections 60(a)-(b)], a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected

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<sup>84</sup> 11 U.S.C. § 96 (1952).

<sup>85</sup> 88 F. Supp. 466 (E.D. Va. 1950). On appeal, the judgment in this case was reversed by a retroactive application of the 1950 amendment to § 60, discussed in the text. *Coin Machine Acceptance Corp. v. O'Donnell*, 192 F.2d 773 (4th Cir. 1951).

that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.

As has already been noted, an entruster can obtain sure protection against lien creditors under the UTRA by filing at any time within the thirty-day period. Does it follow that filing at any time during such period avoids the possibility of a preference? Reference must be made to section 60(a)(7) of the Bankruptcy Act which provides that where applicable law requires "a transfer of property other than real property for or on account of a new and contemporaneous consideration to be perfected by recording, delivery, or otherwise" in order to defeat the rights of lien creditors, the transfer will be deemed made at the time of transfer

- (1) where applicable law specifies a period of *not more than 21 days* after the transfer within which recording, delivery, or other act is required, and compliance is made therewith within the specified period;
- (2) where applicable law specifies no stated period or specifies a period of more than 21 days and compliance is made within 21 days of the transfer.

It would appear to follow that to avoid any possibility of a preference an entruster must file within twenty-one days of the execution of a trust receipt despite the fact that a longer period may be available under the Uniform Act to defeat claims of lien creditors.<sup>86</sup>

One further bankruptcy problem should be noted. Section 67(c) of the Bankruptcy Act<sup>87</sup> subordinates to certain claims statutory liens "on personal property not accompanied by possession of such property." Does this section pose a threat to trust receipts transactions in which the entruster does not take possession? It apparently does not. It has recently been held that a factor's lien is not a statutory lien within the meaning of the Bankruptcy Act, the court stating that that term does not include consensual liens whether or not based on statutory provisions.<sup>88</sup> The same reasoning is applicable to trust receipts.

#### FILING PROVISIONS

It has been noted at the outset that the filing system used under the

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<sup>86</sup> See UNIFORM COMMERCIAL CODE § 9-304, Comment 4 (1957 Official Text). Under the Bankruptcy Act as it existed prior to the 1950 amendments it was held that payments received and repossessions made by an entruster within the thirty day period provided by the UTRA were valid against the trustee in bankruptcy. *In re McManus Motors, Inc.*, 27 F. Supp. 113 (D. Mass. 1939).

<sup>87</sup> 11 U.S.C. § 107(c) (1952).

<sup>88</sup> *In the Matter of Tele-Tone Radio Corp.*, 133 F. Supp. 739, 746-48 (D. N.J. 1955).

act is the system of "notice filing." Since "notice filing" is already familiar to Ohio practitioners under the provisions of the Ohio Assignment of Accounts Receivables Act, it is sufficient to say that such filing requires only the filing of a simple statement effective for a specified period indicating that a lender and borrower are engaged or intend to engage in a financing transaction or transactions; the public statement does not identify any property which is subject to a security interest but imposes on third persons the burden of inquiry as to this matter.

The filing statement required under the Trust Receipts Act<sup>89</sup> must state the following:

- (1) A designation of the entruster and the trustee, and of the chief place of business of each within this state, if any; and if the entruster has no place of business within the state, a designation of his chief place of business outside the state.

With respect to the designation of the parties it should be noted that a Massachusetts court has interpreted the act to require a high degree of accuracy in such designation.<sup>90</sup>

With respect to the designation of the place of business of the parties, section 1316.23 requires that the chief place of business of both parties within the state, if any, must be designated. However, only in the case of the entruster is there specific provision for designating his chief place of business outside the state if he had no place of business within the state. Moreover, section 1316.23 provides that the financing statement shall be filed with the county recorder in the county "where the trustee's chief place of business within this state is located." A literal interpretation of these provisions admits of the conclusion that a financing statement may not be properly filed in Ohio if the trustee cannot be said to have any place of business within Ohio.

- (2) A statement that the entruster is engaged, or expects to

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<sup>89</sup> OHIO REV. CODE §§ 1316.23, .24 (Baldwin 1958).

<sup>90</sup> *General Motors Acceptance Corp., v. Haley*, 329 Mass. 559, 109 N.E.2d 143 (1952) (Where trustee's name was E. R. Millen Co., Inc., financing statement in which the trustee was designated as "E. R. Millen Company" and its signature was "E. R. Millen, Trustee" was invalid.).

Under OHIO REV. CODE § 1316.25 (Baldwin 1958) it is made the duty of the filing officer to mark each financing statement filed with a consecutive file number, and with the date and hour of filing, and to keep such statement in a separate file; and to "note and index the filing in a suitable index according to the name of the trustee and containing a notation of the trustee's chief place of business as given in the statement." *In re Nickulas*, 117 F. Supp. 590 (D. Md. 1954), *aff'd sub nom. Tattelbaum v. Refrigeration Discount Corp.*, 212 F.2d 877 (4th Cir. 1954), held that indexing of the financing statement under the name in which the trustee conducted business rather than in the trustee's individual name was not misleading and did not constitute a substantial defect.

be engaged, in financing under trust receipt transactions the acquisition of goods by the trustee.

The limitation of the above section to goods is not inconsistent with the other provisions indicating that "documents" are subject to the filing provisions. In the case of documents it is the goods, title to which are evidenced by the documents, which are the ultimate subject of financing.

- (3) A description of the kind or kinds of goods covered or to be covered by such financing.

Again, the word "goods" is used. In the case of documents, a description should apparently be made of the goods covered by the documents.

The question of the degree of specificity with which property must be described in a filing statement is of course important. The sample statement set forth in the act<sup>91</sup> lists as examples of such description "coffee, silk, or the like," which would indicate that only the broad class of property need be stated.

- (4) The signatures of the entruster and trustee.

By presentation of the financing statements for filing and payment of the filing fee the entruster obtains the statutory protection which results, for a period of one year after filing.<sup>92</sup> The protection of the filing statement is effective with respect to *documents or goods* which are within one year after filing, or were within thirty days before filing, "the subject matter of a trust receipt transaction between the parties." Presumably property becomes "the subject matter of a trust receipt transaction" when the thirty-day period, defined in section 1316.15(A) commences to run.

At any time before the expiration of the one-year effective period if the financing statement, a similar financing statement, or an affidavit of the entruster alone setting forth the information to be contained in the original financing statement, may be filed.<sup>93</sup> This second filing has the effect of extending the effective period of the first statement so as to cover trust receipt transactions made within an additional year and also has the effect of continuing for an additional year the entruster's protection as to property covered by the earlier statement. Since the additional statement is said to be valid "in like manner and for like period" as the original filing, it is possible, *but by no means clear*, that a series of such additional statements may be filed annually so as to give the entruster an indefinite period of protection.

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<sup>91</sup> OHIO REV. CODE § 1316.24 (Baldwin 1958).

<sup>92</sup> OHIO REV. CODE § 1316.26 (Baldwin 1958).

<sup>93</sup> OHIO REV. CODE § 1316.27 (Baldwin 1958).

The UTRA, as originally written, provided for "central filing," that is, filing with the Secretary of State. The Ohio act, however, provides for "local" filing, with the county recorder of the county where the trustee's chief place of business in Ohio is located. The change was apparently made in the belief that since all other Ohio recording or filing acts require local recording, it would be burdensome to require third parties in checking title to property to check some liens locally and trust receipts liens centrally.

However, by using the language "chief place of business" the legislature may have created a far more serious problem than would have been presented by the adoption of central filing. For example, where a trustee corporation's principal office as designated by its articles of incorporation is located in one county within the state but its major business establishment is in another county, where should the statement be filed? If the trustee is an individual who resides in one Ohio county but has his place of business in another, it would appear that the statement should be filed with the recorder of the latter county<sup>94</sup> although any chattel mortgage or conditional sales contract affecting his title to property would properly be filed in the county of residence.<sup>95</sup>

The effect of the use of this unfamiliar language, "chief place of business," to designate the place of filing would thus seem to be twofold. First, it may create uncertainty on the part of the entruster as to the proper county for filing. Second, it may force the careful lender who is checking the borrower's title to property to search in two or more counties.<sup>96</sup>

It is also unfortunate that the act, unlike the Ohio Assignment of Accounts Receivable Act,<sup>97</sup> has no specific conflict of laws provision. It is thus unclear, in connection with multi-state trust receipt transactions, whether filing should be made in the state where the entrusted property is located, where the trust receipt is issued, or where the chief office of the trustee is located. Perhaps the provisions of section 1316.23 referred to earlier afford some support for a choice of the third of these alterna-

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<sup>94</sup> This would also be true under OHIO REV. CODE § 1325.03 (Baldwin 1958) (Assignment of Accounts Receivable Act) and OHIO REV. CODE § 1311.61 (Baldwin 1958) (Factor's Lien Act) which provide for filing in the county of the borrower's "principal place of business." The latter statute further provides that where the borrower is a corporation, its "principal place of business" shall be the principal office in this state designated by the records of the Secretary of State.

<sup>95</sup> Chattel mortgages and conditional sale contracts are required by OHIO REV. CODE §§ 1319.01, .11 (Baldwin 1958), respectively, to be filed in the county where the mortgagor or vendee resides, or if a non-resident, then where the property is situated. For a corporation, the county of residence is the county designated in its articles of incorporation as the location of its principal office. *Sweeny v. Driller Co.*, 122 Ohio St. 16, 170 N.E. 436 (1930).

<sup>96</sup> Caution would seem to require that an entruster file and a lender search the records in both the county of residence (for a corporation, principal office as per articles of incorporation) and the county of the major business establishment.

<sup>97</sup> OHIO REV. CODE § 1325.02 (Baldwin 1958).

tives. Probably, however, until the conflicts problem is clarified by the cases, multiple filings will in some cases be the only safe course.<sup>98</sup>

The act makes no specific provision with respect to determining priorities between two entrusters lending money on the same property. The classic problem in this area would arise as follows: A files a financing statement indicating his intent to enter a trust receipt transaction with B covering property of a certain class. C subsequently files a financing statement indicating his intent to enter a trust receipt transaction with B covering property of the same class. C then lends B money, taking a trust receipt on property of the class described in his financing statement. After C makes this loan, A lends B money, taking a trust receipt on the same property. The issue is, of course, which of A and B prevails, A, the first to file, or B, the first to give value.

In *Donn v. Auto Dealers Inv. Co.*,<sup>99</sup> the Supreme Court of Illinois held that B, the first to give value, prevails in the above situation. The court distinguished the filing of the financing statement by A from the case of the filing of a mortgage to secure future obligatory advances on the ground that the filing of the financing statement did not constitute a commitment to make advances.

As a practical matter, the situation in *Donn* is unlikely to occur often in Ohio since the Ohio act follows the original draft of the Uniform Act in being largely limited to the financing of new acquisitions. However, in Illinois, the Uniform Act has been amended to extend trust receipt financing to old inventory<sup>100</sup> and the problems of double financing at the wholesale level are accordingly more severe.

#### THE ENTRUSTER'S RIGHTS TO PROCEEDS

One of the features of the UTRA distinguishing it from the chattel mortgage or conditional sales acts is its express provisions with respect to the secured party's rights to the proceeds of property subject to his security interest.

It has already been noted that under section 1316.19 the entruster is, in the case of a purchase by a third person of any entrusted property on credit, entitled to "any debt owing to the trustee and any security therefor, by reason of such purchase." Section 1316.20 gives the entruster certain further rights to proceeds of entrusted property but, as is not expressly provided under section 1316.19, only if one of the two following conditions is met:

- (1) Under the terms of the trust receipt transaction, the trustee has no liberty of sale or other disposition.

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<sup>98</sup> This conflict issue was presented and avoided in *Barrett v. Bank of Manhattan Co.*, 218 F.2d 763 (2d Cir. 1954).

<sup>99</sup> 385 Ill. 211, 52 N.E.2d 695 (1944).

<sup>100</sup> ILL. ANN. STAT. c. 121½ § 167(1)(c) (Smith-Hurd Supp. 1957).

- (2) Under the terms of such transaction, the trustee, having liberty of sale or other disposition, is to account for the proceeds of any disposition.

Section 1316.20 provides that the entruster shall have the rights to proceeds therein granted "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." For example, if an entruster is protected against all lien creditors at the time of the sale of entrusted property, either because such sale has occurred within the thirty-day period or by reason of filing, the entruster's rights to proceeds will prevail over rights of lien creditors thereto.

There is no specific provision as to the persons against whom the entruster's right to debts from purchasers and security therefor, under section 1316.19, is valid. However, the above rule, though literally limited to rights under section 1316.20, would appear equally applicable to rights under section 1316.19.

#### RIGHTS TO PROCEEDS UNDER SECTION 1316.20

Under Revised Code section 1316.20 the entruster is given certain rights to three classes of proceeds, which will be discussed separately:

- (1) Debts described in section 1316.19.
- (2) Proceeds whether or not identifiable.
- (3) Identifiable proceeds.

##### (1) *Debts described in section 1316.19*

This provision of section 1316.20 obviously adds nothing to the entruster's rights under section 1316.19. The only question is whether it qualifies those rights. Section 1316.19 does not itself condition the entruster's rights on his either withholding liberty of sale or imposing a duty to account for proceeds whereas all rights under section 1316.20 are so conditioned. It is unclear whether these conditions should be read into section 1316.19 by reason of the reference to that section contained in section 1316.20.

##### (2) *Proceeds whether identifiable or not*

Section 1316.20(B) gives the entruster rights

to any proceeds or the value of any proceeds, whether such proceeds are identifiable or not, of the goods, documents or instruments, if said proceeds were received by the trustee within ten days prior to either application for appointment of a receiver of the trustee, or the filing of a petition in bankruptcy or judicial insolvency proceedings by or against the trustee, or demand made by the entruster for prompt accounting; and to a priority to the amount of such proceeds or value.

The rights to proceeds of entrusted property under this section are available, it will be noted, only if within ten days after the *actual date* of receipt of proceeds of entrusted property by the trustee, regardless of whether the entruster has notice of the receipt of such proceeds, either the entruster demands an accounting or a bankruptcy or insolvency petition is filed. The term "demand for an accounting" has been interpreted in a non-technical sense; a demand for payment of the sale proceeds and the taking of possession of a trade-in have both been held to constitute compliance with the statutory requirement.<sup>101</sup>

The effect of the section is to give the entruster a charge against the general assets of the trustee to the extent of the value of proceeds received within the ten-day periods designated. Crucial to a determination of the validity of such a charge in bankruptcy is the question whether such charge constitutes a lien or a mere priority. A lien is a security interest in property of a debtor, which interest is enforceable under certain circumstances whether the debtor is insolvent or not. A priority is a preferred claim against a debtor's estate enforceable only in insolvency proceedings. A security interest valid under state law is ordinarily valid in bankruptcy whereas, under section 64 of the Bankruptcy Act<sup>102</sup> as amended in 1938, state-created priorities with the exception of landlords' priorities for rent are denied priority under the Bankruptcy Act. Factors looking towards a conclusion that the rights of the entruster constitute a lien are the following:

(1) The entruster's rights in the entrusted property prior to disposition is clearly a lien. The general scheme of section 1316.20 is to extend to proceeds whatever right the entruster has in the entrusted property.

(2) The entruster's right may be enforced *even if the trustee is not insolvent* to the extent of proceeds received within ten days before a demand for an accounting.

Factors looking towards a conclusion that the rights of the entruster under section 1316.20(B) are a priority are:

(1) The use of the word "priority" in the section. (However, it should be noted that at the time of the preparation of the original draft state-created priorities were valid under the Bankruptcy Act, and there was not so pressing a need as there would be today to be precise in terminology.)

(2) The entruster's charge is against the general assets of the trustee rather than against specific property.

In *In re Harpeth Motors, Inc.*,<sup>103</sup> the Tennessee Federal District Court held that the rights of the entruster under section 10(b) of the

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<sup>101</sup> *People's Fin. and Thrift Co. of Visalia v. Bowman*, 58 Cal. App. 2d 729, (4th Dist. 1943); *Universal Credit Co. v. Citizens State Bank*, 224 Ind. 1, 64 N.E.2d 28 (1945).

<sup>102</sup> 11 U.S.C. § 104 (1952).

<sup>103</sup> 135 F. Supp. 863 (D. Tenn. 1955).

UTRA [Ohio Revised Code section 1316.20(B)] constitute a lien rather than a priority, relying mainly on the two points set forth above as supporting such a conclusion. The *Harpeth Motors* decision has been approved by a Tennessee appellate court.<sup>104</sup>

If the *Harpeth Motors* case is correct in holding that the entruster's right to unidentifiable proceeds is a security interest, it would follow that the entruster need not comply with the provisions of the Bankruptcy Act relating to the filing of claims in order to preserve such right. However, one case prior to the *Harpeth Motors* case held that the entruster must file a claim in bankruptcy to preserve his right to unidentified proceeds which the court gave the novel title of a "preferred lien."<sup>105</sup> In any event, in order to protect himself against the disbursement of funds due him under section 1316.20 the entruster should give the trustee in bankruptcy some written notice of his rights.

### (3) *Identifiable Proceeds*

Section 1316.20(C) gives the entruster the rights to identifiable proceeds of entrusted property

unless the provision for accounting has been waived by the entruster by words or conduct; and knowledge by the entruster of the existence of proceeds, without demand for accounting made within ten days from such knowledge, shall be deemed such a waiver.

In certain areas the application of this section is clear. If the trustee exchanges property for other property, such other property may become subject to the entruster's lien under this section. Similarly, if the entruster sells entrusted property for cash and deposits the cash in a separate bank account, or intermingles the cash proceeds with funds of his own in such a manner that the cash proceeds remain identifiable under customary tracing rules, the cash proceeds may be subject to the entruster's lien.

The difficult area of the section's application has concerned the entruster's right to proceeds which are not in the hands of the trustee. One court has held that none of the provisions of section 1316.20 apply to proceeds not in the hands of the trustee<sup>106</sup> but this holding seems completely unjustified by the language of the section, except, of course, in the case of section 1316.20(B). The most troublesome case arises as follows:

A, a wholesale financier, loans money to B, a dealer, taking a trust

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<sup>104</sup> *Commercial Union Bank of Nashville v. Alexander*, 312 S.W.2d 611 (Tenn. App. 1957).

<sup>105</sup> *Crusoe v. Associates Discount Corp.*, 129 F. Supp. 598 (N.D. Fla. 1955).

<sup>106</sup> *Citizens Nat'l Trust & Sav. Bank v. Beverly Fin. Co.*, 127 Cal. App. 2d 835, 273 P.2d 714 (App. Dep't Superior Ct. Los Angeles county 1954).

receipt. B sells the entrusted property to C, the sale being secured by a conditional sale contract or a chattel mortgage. B assigns the conditional sale contract or chattel mortgage to D, a retail financier, for value. B fails to account to A for the proceeds of his transaction with D. B becomes insolvent or decamps. The question then arises: Can A recover the conditional sale contract or chattel mortgage or its value, from D?

The case authority under the act is badly divided on the above question. The only principle which can be said to unite the cases is a refusal to base their results on a close reading of the statute. Thus several California cases hold for the retail financier on the non-statutory ground of estoppel: that the entruster having chosen to deal with the trustee and invest him with indicia of ownership should bear the risk of his dishonesty.<sup>107</sup>

Other cases have held for the retail financier by concluding that in taking an assignment of the conditional sales contract or chattel mortgage for value it is entitled to the protection accorded under section 1316.16 to "purchasers taking from the trustee for value, in good faith, and by transfer in the customary manner instruments in such form as are by common practice purchased and sold as if negotiable."<sup>108</sup> The cases which hold that conditional sales contracts or chattel mortgages are "instruments in such form as are by common practice purchased and sold as if negotiable" stress heavily the great volume in assignments of such contracts. The consideration of market volume seems relevant to the second part of the above quoted phrase, *i.e.*, "as are by common practice purchased and sold as if negotiable" since great market volume indicates that conditional sales contracts, like negotiable instruments, are transferred readily without close examination of the dealings between the parties to the paper. However, it is difficult to see how the manner or volume of trading bears on the question whether a conditional sales contract or chattel mortgage is an "instrument" within the definition of section 1316.01(E). It is rather difficult to bring a conditional sales contract or chattel mortgage within this definition. Some cases have held

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<sup>107</sup> Commercial Credit Co. v. Barney Motor Co., 10 Cal. 2d 718, 76 P.2d 1181 (1938); People's Fin. and Thrift Co. of Visalia v. Bowman, 58 Cal. App. 2d 729, 137 P.2d 729 (4th Dist. 1943); General Credit Corp. v. First Nat'l Bank of Cody, 74 Wyo. 1, 283 P.2d 1009 (1955). Other cases have rejected similar estoppel arguments. C.I.T. Corp. v. Commercial Bank of Patterson, 64 Cal. App. 2d 722, 149 P.2d 439 (1st Dist. 1944); National Funding Corp. v. Stump, 57 Cal. App. 2d 29, 133 P.2d 855 (4th Dist. 1943).

<sup>108</sup> Conditional sales contracts: Citizens Nat'l Trust & Sav. Bank v. Beverly Fin. Co., *supra* note 106; Farmers Nat'l Bank of Amsterdam v. Universal Credit Co., 259 App. Div. 955, 20 N.Y.S. 2d 1004 (3d Dep't) *reargument and leave to appeal denied*, 260 App. Div. 815, 22 N.Y.S.2d 532 (3d Dep't), *leave to appeal denied*, 784 N.Y. 818, 29 N.E.2d 975 (1940), summarized and approved in Citizens Nat'l Bank of Springville v. Conger, 176 Misc. 1048, 1050, 29 N.Y.S.2d 65, 67 (Superior Ct. Erie county 1941). Chattel mortgage: General Credit Corp. v. First Nat'l Bank of Cody, *supra* note 107.

that conditional sales contracts are not "instruments in such form as are by common practice purchased and sold as if negotiable."<sup>109</sup>

Some cases have held that the wholesaler financier prevails, basing their conclusion on section 10 of the UTRA (Ohio Revised Code section 1316.20) without making any detailed analysis of this section.<sup>110</sup> Perhaps an alternative section which might afford some comfort to the entruster is section 9(3) (Ohio Revised Code section 1316.19) which gives him rights to debts due the trustee from a purchaser of entrusted property "and any security therefor." However, it must be conceded that the act does not provide a very clear guide to a solution of controversies between the wholesale and retail financier.

Policy considerations would appear to favor the protection of the retail financier. The purpose of trust receipt financing is usually to facilitate the sale of the entrusted property. In many businesses in which such financing is used the sale of the entrusted property can only be effected if financing of the sale can be obtained. Therefore, to give the wholesale financier rights superior to the retail financier may greatly discourage retail financing and frustrate the very purpose of the trust receipt transaction. Furthermore, to deny the wholesale entruster rights against the retail financier does not put him in a worse position than he would be in if the trustee were to engage in a cash sale. In either case the entruster would have to rely on the honesty of the trustee in accounting for cash proceeds.

The rights of the retail financier depend, even in the cases in which he has prevailed, on his lack of actual notice of the entruster's interest in the property in question. It has been held that mere knowledge of a general practice of "floor planning" does not constitute actual notice of the entruster's rights.<sup>111</sup> In one case, even though the retail sale was a purely fictitious one set up for the sole purpose of obtaining double financing, a retail financier without notice of the fictitious character of such sales was held to have acted in good faith and without actual notice of the entruster's interest.<sup>112</sup>

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<sup>109</sup> *Canandaigua Nat'l Bank and Trust Co. v. Commercial Credit Corp.*, 285 App. Div. 7, 135 N.Y.S.2d 66 (4th Dep't 1954); *General Motors Acceptance Corp. v. Associates Discount Corp.*, 38 N.Y.S.2d 972 (Mun. Ct. Syracuse 1942), *rev'd on other grounds*, 267 App. Div. 1032, 48 N.Y.S.2d 242 (4th Dep't 1944).

<sup>110</sup> *Universal Credit Co. v. Citizens State Bank*, 224 Ind. 1, 64 N.E.2d 28 (1945); *B.C.S. Corp. v. Colonial Discount Co.*, 169 Misc. 711, 8 N.Y.S.2d 65 (City Ct. New York 1938).

<sup>111</sup> *E.g.*, *Commercial Credit Co. v. Barney Motor Co.*, *supra* note 107; *People's Fin. and Thrift Co. of Visalia v. Bowman*, *supra* note 107; *Citizens Nat'l Trust & Sav. Bank v. Beverly Fin. Co.*, *supra* note 106; *Security First Nat'l Bank of Los Angeles v. Taylor*, *supra* note 81. In some cases the retail financier has been defeated by the entruster by proof that the retail financier had actual knowledge that a trust receipt was outstanding on the property in question. *E.g.*, *General Motors Acceptance Corp. v. Associates Discount Corp.*, *supra* note 109.

<sup>112</sup> *Citizens Nat'l Trust & Sav. v. Beverly Fin. Co.*, *supra* note 106. See

It should be noted that under section 1316.20(C) the entruster has a right only to identifiable proceeds if he demands an accounting for proceeds within ten days of the knowledge of the existence of such proceeds,<sup>113</sup> whereas section 1316.20(B) conditions rights to proceeds, whether identifiable or not, on a demand for accounting within ten days of the receipt of proceeds regardless of the state of the trustee's knowledge. It should further be noted that the requirement of section 1316.20(C) of a demand for an accounting within ten days of knowledge of the existence of proceeds is only one specific example of conduct required to avoid a waiver of rights to an accounting. Such rights can be waived and the benefits of section 1316.20(C) accordingly lost, not only by failure to make a demand for accounting within the statutory period, but through a course of conduct indicating a lack of diligence on the part of the entruster in policing the status of entrusted property and proceeds therefrom.<sup>114</sup>

#### PLEDGE UNACCOMPANIED BY POSSESSION

Tucked away among the various provisions of the UTRA are three short sections having nothing to do with trust receipts which significantly affect the Ohio law relating to a separate and distinct type of security device, the common law pledge. Sections 1316.07, 1316.08 and 1316.09 codify a set of rules governing the validity as against third parties of an attempted pledge or agreement to pledge not accompanied by delivery of possession, sometimes referred to as an "equitable" or "imperfect" pledge. The application of these rules is not restricted by sections 1316.02 and 1316.06, discussed previously, which impose definite limitations on what may constitute a "trust receipt transaction." It is clear that the pledge provisions apply to purchase money and non-purchase money transactions alike, and irrespective of the purpose of possession by the pledgor.<sup>115</sup>

The extent to which a creditor of the pledgor can defeat the pledgee's rights in an equitable pledge situation, depends upon whether the pledgee has given "new value" or merely "value." Under section

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also *North American Acceptance Corp. v. Northern Illinois Corp.*, 347 Ill. App. 89, 106 N.E.2d 197 (2d Dist. 1952).

<sup>113</sup> It has been held that under this section the entruster has a property interest in proceeds from the moment of their coming into being, which interest is subject to defeasance upon the entruster's failure to make demand within the ten day period. *Commercial Credit Corp. v. Bosse*, 76 Idaho 409, 283 P.2d 937 (1955). In the *Bosse* case a garnishee who attached the trustee's bank account within the ten day period before the entruster made his demand unsuccessfully contended that § 10(c) of the UTRA [OHIO REV. CODE § 1316.20(C) (Baldwin 1958)] merely gives the entruster an inchoate lien on identifiable proceeds which is perfected only upon the making of the demand by the entruster.

<sup>114</sup> *McCloskey v. J. Henry Schroder Banking Corp.*, 7 Misc. 2d 501, 168 N.Y.S.2d 522 (Sup. Ct. Trial Term N.Y. county 1957).

<sup>115</sup> The purpose of possession under OHIO REV. CODE § 1316.09 (Baldwin 1958), however, must be "temporary and limited."

1316.07, where the pledgee has given new value, his rights will be upheld as against all creditors with or without notice for ten days thereafter; where, however, the pledgee gives value which is not new value, or in the case of new value after the lapse of ten days from the giving thereof, the pledge will be valid against lien creditors without notice<sup>116</sup> only as of the time the pledgee takes possession and without relation back.<sup>117</sup> For purposes of this section, as well as of sections of the UTRA relating to trust receipts, a creditor attains the status of lien creditor as of the date of the issuance of process where the attachment or levy follows within a reasonable time after such issuance.<sup>118</sup>

It would seem clear that the pledgee who gives new value will not be deemed under section 60 of the Bankruptcy Act to have taken property of the pledgor for, on or account of an antecedent debt if he takes possession at any time within the ten-day period. This follows from the fact that, having been created by the statute, the interest of the pledgee during such ten-day period, though unaccompanied by possession, could hardly be held to be an "equitable lien" under section 60a(6) of the Bankruptcy Act. Furthermore, such a taking of possession after advancing the funds but prior to the expiration of ten days is deemed to have been a contemporaneous transaction under section 60a(7) of the Bankruptcy Act since it is perfected within the stated period of time specified by the applicable law, the same being less than twenty-one days.

Purchasers for value and without notice are given full protection under section 1316.08 which provides, without reference to the ten-day period, that they take free of the pledgee's rights unless prior to the purchase the pledge has been perfected by possession taken.

Section 1316.09 provides that where a person, for a temporary and limited purpose, delivers property "in which he holds a pledgee's or other security interest" to the holder of the beneficial interest, the transaction has the same effect as a purported pledge for new value under sections 1316.07 and 1316.08. The words "or other security interest" could lead to a conflict with other provisions of Ohio law unless construed to be limited to transactions in the nature of pledge and not including any

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<sup>116</sup> This probably means notice at the time process was issued rather than at the time credit was extended although there would seem to be no logical reason why notice or lack of notice on the part of the creditor at the time he issues process should be significant. Unlike a subsequent purchaser or taker of a security interest, the levying creditor without notice cannot be said to have relied to his detriment on the possession of the pledgor.

<sup>117</sup> The definition of "possession" contained in the UTRA, which in the case of goods includes constructive possession by means of tags, signs, etc., is expressly limited to "possession taken or retained by the entruster" and, hence, would not apply. OHIO REV. CODE § 1316.01(I) (Baldwin 1958). However, it is well established in Ohio that under certain circumstances constructive possession or a symbolical delivery is effective to validate a pledge. *Dale v. Pattison*, 234 U.S. 399 (1914).

<sup>118</sup> OHIO REV. CODE § 1316.15(B)(1) (Baldwin 1958) to which specific reference is made in OHIO REV. CODE § 1316.07(B) (Baldwin 1958).

security interest documented in such a way as to fall under some other statute requiring filing or recording in the absence of a change of possession.<sup>119</sup>

The avowed purpose of the Commissioners on Uniform Laws in adopting the provisions embodied in section 1316.07 was to exclude the use of the pretended or unperformed pledge, dated back more than four months, from draining insolvent estates.<sup>120</sup> Conceding this to be a worthwhile objective, one might still question the logic of including such provisions in an act dedicated to the subject of trust receipt financing.

Furthermore, it seems more likely that the effect of this section is to benefit the pledgee rather than the creditors of the pledgor.<sup>121</sup> The pre-existing common law rule generally followed is that an equitable pledge will be enforced between the parties and against purchasers with notice and, in some states, general creditors but not against subsequent bona fide purchasers or lien creditors.<sup>122</sup>

Likewise, it appears that in Ohio the general effect of section 1316.07 is to increase the protection previously accorded a pledgee at the expense of the pledgor's creditors by giving to the pledgee an extra ten days in which to perfect his security. At an early date the Ohio Supreme Court in the case of *Thorne v. First Nat'l Bank*<sup>123</sup> held that a purported pledge not accompanied by the receipt and retention of possession by the pledgee was void as against the pledgor's creditors. In *Klaustermeyer v. Trust Co.*,<sup>124</sup> the one case in which an equitable pledge was upheld against creditors of the pledgor, the result was predicated upon the finding and the agreement of counsel that the pledgor's assignee for the benefit of creditors did not occupy the status of an intervening third party.<sup>125</sup>

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<sup>119</sup> See Bacon, *supra* note 4, at 270, for the view that an unfiled chattel mortgage would be within the scope of this section.

<sup>120</sup> See *Commissioner's Prefatory Note on "What the Uniform Trust Receipt Act Does,"* 9C UNIFORM LAWS ANN. 228 (1957).

<sup>121</sup> One commercial transaction in which the imperfect pledge provisions of the UTRA may be useful is the broker's "day loan" or "clearance loan." Under this transaction the financier, commonly a bank, makes a loan to a broker in the morning of a business day which enables him to obtain delivery of securities for purpose of sale during the day. At the end of the day the loan is paid out of the proceeds of securities sold. Prior to the adoption of the UTRA, if the broker became insolvent within the subsequent four months, there was a possibility that payments to the bank by the broker might be considered preferential. See *National City Bank v. Hotchkiss*, 231 U.S. 50 (1913). However, under the UTRA the bank may obtain a lien on securities and their proceeds by having the broker on the morning of the business day enter into an agreement to pledge covering the securities to be delivered to the broker during the day and their proceeds. Alternatively, the bank may obtain a lien by way of trust receipt, under the provisions of OHIO REV. CODE § 1316.02 (Baldwin 1958).

<sup>122</sup> 72 C.J.S. *Pledges* § 14 (1951).

<sup>123</sup> 37 Ohio St. 254 (1881).

<sup>124</sup> 89 Ohio St. 142, 105 N.E. 278 (1913).

<sup>125</sup> It was held that an assignee for the benefit of creditors takes the property

INTERRELATION OF UTRA AND OTHER OHIO  
LAWS GOVERNING COMMERCIAL TRANSACTIONS

What method of secured financing should be used where either the UTRA or some other security device is available? How does the UTRA affect other commercial transactions? In the light of the UTRA, what new hazards must be anticipated and what additional safeguards must now be taken by the lender whose primary concern is that his security instrument (whether chattel mortgage, conditional sale contract, factor's lien or assignment of accounts receivable) constitute the first and best lien against the property covered thereby?

These vital questions can best be answered by separately considering the relationship of the UTRA to each of a number of the pre-existing Ohio laws covering commercial transactions. Before doing so, however, it should be observed that where a transaction falls within the provisions of the UTRA or any other Ohio statute requiring filing or recording, section 1316.30 gives the secured party the alternative of complying with the provisions of either law and receiving the protection given by the provisions complied with. Therefore, the Ohio statutes governing chattel mortgages, conditional sales and factor's liens, in many instances, will present methods of security financing alternative to the trust receipt.

*Chattel Mortgages*

In the past some use of the chattel mortgage has been made for the purpose of preserving a lender's security interest in property held by a dealer for sale.<sup>126</sup> It would seem, however, especially where a series of transactions is contemplated, that for the purpose of financing a dealer's stock in trade the chattel mortgage is so far inferior to the trust receipt, as not to be in the same class with the latter.

The UTRA, in contrast to the chattel mortgage law, was designed for the specific purpose of inventory financing and its provisions are streamlined to effectuate this purpose. Thus, it contemplates the sale by the trustee of the goods and imposes no technical requirements as to accounting by the trustee which must be strictly observed at the risk of invalidating the lien on the goods as against the trustee's creditors.<sup>127</sup>

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charged with all the liens against it while possessed by the assignor. Cf. OHIO REV. CODE § 1316.15(B)(2) (Baldwin 1958) which confers upon an assignee for the benefit of creditors the status of a lien creditor without notice.

<sup>126</sup> Even though properly filed, a chattel mortgage under which the mortgagor has the power to sell the mortgaged property is fraudulent and void as against creditors of the mortgagor and subsequent purchasers and mortgagees in good faith. *Francisco v. Ryan*, 54 Ohio St. 307, 43 N.E. 1045 (1896); *Collins v. Myers*, 16 Ohio 547 (1847). But where the mortgagor must account to the trustee for the proceeds of sale, the mortgage is not void as against creditors of the mortgagor. *In re Chas. M. Ingersoll Co.*, 222 F.2d 120 (6th Cir. 1955); *Kleine, Hegger & Co. v. Katzenberger & Co.*, 20 Ohio St. 110 (1870).

<sup>127</sup> The UTRA nowhere by its terms requires that the trustee account to the entruster for the proceeds of sale. Nevertheless, the act seems to contemplate that

Unlike the chattel mortgage, only a single statement of trust receipt financing need be filed which covers any number of separate transactions and such a statement need not set forth a specific description of the encumbered property.<sup>128</sup> Where there has been a failure to file, the entruster is given broader protection than is the mortgagee.<sup>129</sup>

The UTRA provides the secured party with a new and valuable addition to his arsenal of remedies which is unavailable to the mortgagee—the right to claim the proceeds or debt arising from a sale of goods by the borrower.

A final consideration indicating the superiority of the trust receipt over the chattel mortgage is that the entruster's rights on default with respect to a sale of property are spelled out with clarity in section 1316.13(C)(2) and are more favorable than the similar rights enjoyed by a chattel mortgagee.<sup>130</sup>

Turn now to the area of conflict between these two security devices. There are two types of situations where a lender may take a chattel mortgage feeling confident, on the basis of his experience prior to enactment of the UTRA, of the inviolability of his security interest, only to find subsequently that his rights are inferior to those of an entruster. The first situation is the capital loan type of transaction where the borrower requests a loan on the security of goods already in his possession representing that he has a free and unencumbered title thereto. Actually, however, the goods are the subject of a trust receipt transaction un-

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such a provision will be standard in trust receipts [See, for example, OHIO REV. CODE § 1316.19 (Baldwin 1958)] and, furthermore, the requirement of accounting gives the entruster certain valuable rights under OHIO REV. CODE § 1316.20 (Baldwin 1958) in proceeds of a sale by the trustee.

<sup>128</sup> The statement provided for under OHIO REV. CODE §§ 1316.23, .24 (Baldwin 1958) is short and simple requiring no affidavit or other formalities. A chattel mortgage, on the other hand, must be accompanied by an affidavit which adheres strictly to the statutory language. OHIO REV. CODE § 1319.04 (Baldwin 1958); *Schuster v. Wendling*, 116 F.2d 596 (6th Cir. 1941). A chattel mortgage must be refiled every three years. OHIO REV. CODE § 1319.05 (Baldwin 1958). Refiling of a trust receipt statement must take place within one year. OHIO REV. CODE §§ 1316.26, .27 (Baldwin 1958).

<sup>129</sup> As has been pointed out earlier, under the UTRA a subsequent claimant of a security interest must obtain possession in order to prevail over the entruster who has failed to file his statement. However, under the UTRA a person who takes a security interest in goods, in consideration of value which is not "new," after the thirty-day period and takes possession before the entruster's statement is filed can defeat the entruster's interest although he could not defeat an unfiled chattel mortgage.

<sup>130</sup> In order to preserve his right to collect a deficiency, a chattel mortgagee who repossesses and sells the mortgaged property before foreclosure in court, must comply with the provisions of OHIO REV. CODE § 1319.07 (Baldwin 1958). This section requires at least ten days' notice to the mortgagor personally or by registered (or certified) mail while OHIO REV. CODE § 1316.13(C)(2) (Baldwin 1958) requires only five days' notice to the trustee personally or by regular mail.

accompanied by filing, and the innocent-appearing borrower is in reality a trustee.<sup>131</sup> If the lender makes the loan and in consideration thereof receives a chattel mortgage on the goods, which he files for record forthwith, his rights in the goods are nevertheless inferior to those of the entruster unless the mortgagee also obtains delivery of the goods from the trustee before the entruster files a statement.<sup>132</sup>

The second situation arises out of a sale of goods by the trustee. Very often a trust receipt transaction will cover goods of a type that are purchased by the retail buyer on an installment basis.<sup>133</sup> The retail installment sale made by the trustee gives rise to a debt secured by a chattel mortgage or conditional sales contract ("retail paper") which is then sold or discounted to a finance company. Serious questions arise under the UTRA as to who is entitled to the retail paper in a contest between the entruster and the finance company. As has been pointed out above, the sections of the UTRA<sup>134</sup> which bear upon this problem do not provide any clear indication of the answer. Under sections 1316.19 and 1316.20(A) and (C), the entruster can lay claim to the retail paper as being "debt owing to the trustee and any security therefor" or "proceeds which are identifiable."<sup>135</sup> The finance company, on the other hand, can assert its immunity against a claim of the entruster by virtue of being a purchaser, under section 1316.16, of "instruments in such forms as are by common practice purchased and sold as if negotiable,"<sup>136</sup> and if the finance company prevails on this ground, it would make no difference whether or not the entruster had filed a statement.

It is extremely difficult to predict what result an Ohio court might reach in such a dispute between an entruster and finance company over

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<sup>131</sup> The "equitable pledge" provisions of the UTRA raise no such problem. A mortgagee or other secured party for value and without notice is fully protected, even within the ten-day period, against the pledgee who has not taken possession. OHIO REV. CODE § 1316.08 (Baldwin 1958).

<sup>132</sup> This example assumes the giving of "new value" by the mortgagee, making it immaterial whether the transaction occurred during or subsequent to the thirty-day period. The result is the same if the mortgagee gives "value" more than thirty days after delivery of the goods to the trustee. If, however, the mortgagee gives "value" at a time within such thirty-day period, under no circumstances can he prevail over the entruster. The controlling rules are set forth in OHIO REV. CODE § 1316.18(B) (Baldwin 1958).

<sup>133</sup> An examination of the documents filed under the UTRA in Cuyahoga county (473 filings as of August 23, 1958, one year, lacking a week, after the act became effective) reveals that the goods covered are almost exclusively appliances. It was also interesting to note that in addition to statements in the form prescribed by OHIO REV. CODE § 1316.24 (Baldwin 1958) there were filed a large number of actual trust receipts, some with and some without conditional sale type affidavits attached. Query the protection, if any, afforded the entruster by the filing of such trust receipt.

<sup>134</sup> See OHIO REV. CODE §§ 1316.14-.20 (Baldwin 1958).

<sup>135</sup> See pp. 714-16 *supra*.

<sup>136</sup> The cases which have considered this contention appear at notes 108, 109, *supra*.

the right to retail paper. If the rights of the entruster are given priority, clearly he will prevail if at the time of the "disposition" of goods by the trustee a statement was on file; on the other hand, if at the time of such disposition and assignment of retail paper, the entruster had not filed, it would seem that the finance company should win over the entruster [perhaps, on the basis of a combination of the provisions of Revised Code sections 1316.17 and 1316.18(B)], but such a result is far from certain.

While it may be possible that the purchaser of retail paper will gain absolute protection against the entruster where the latter has failed to file a statement, it is certain that the chattel mortgagee in the capital loan situation acquires no rights as against such entruster in the absence of the mortgagee's taking possession of the goods. There is no foolproof way of protecting the mortgagee. Certain steps can be taken, however, to cut down the risks. First of all, caution requires that before releasing funds to the borrower it should be ascertained that the goods in question have been in his possession for at least thirty days preceding a check of the recorder's index.<sup>137</sup> Even though such search reveals no trust receipt statement, the mortgagee should be aware of the possibility nevertheless of there being an outstanding trust receipt covering the goods. Because under the UTRA the person who sold the goods to the borrower need not have been a party to arranging the financing thereof pursuant to a trust receipt transaction, there is no other person besides the borrower who can be consulted by the mortgagee to obtain absolute assurance of the non-existence of an unfiled trust receipt statement. Thus, the mortgagee should exercise a greater than ordinary degree of caution in satisfying himself that the mortgagor is a trustworthy person; further, he may do well to insist upon an affidavit of the mortgagor attesting the freedom of the goods from any lien imposed by a trust receipt.

Needless to say, until the law is clarified, where a statement of trust receipt financing appears of record, the person who is purchasing retail mortgage paper (just as the mortgagee making the capital loan) should, in order to protect himself, obtain from the entruster a release or waiver of all claims.

There is yet another way in which the unsuspecting chattel mortgagee may have his lien impaired under the provisions of the UTRA. Section 1316.30, mentioned at the outset of this section of the paper, further provides that regardless of which law is complied with by the secured party, his rights in the goods are subject to the claims of the lienors preferred under section 1316.21. Thus, the chattel mortgagee who by the nature of the transaction could have used a trust receipt as

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<sup>137</sup> The Cuyahoga county recorder indexes all chattel mortgages and conditional sales contracts and notices of trust receipts, factors' liens and assignments of accounts receivable in a single master index. It should be kept in mind that it may be necessary to check in two different counties if the borrower's county of residence differs from the county of its "chief place of business." See p. 710 *supra*.

his security instrument had he so desired, may subsequently find that his rights have become subordinate to the liens of the parties with whom the trustee deals regarding the processing, warehousing, shipping, etc. of the goods preparatory to their sale.<sup>138</sup>

### *Conditional Sales*

By advancing to a vendor the purchase price of goods and taking from him an assignment of a conditional sales contract covering the goods executed by the vendee, a person can achieve a secured position which parallels that of an entruster under the UTRA. The security interest would be upheld against creditors of the vendee even though the latter has a power to sell the goods, provided he is required, in accordance with the terms of the contract, to account strictly to the vendor or his assignee for the proceeds of sale.<sup>139</sup>

Even prior to enactment of the UTRA, however, the conditional sale contract was seldom used in Ohio. The great deterrent to such use is the pre-requisite to repossession by the vendor which applies to all sales except those of more than \$5000.00 or involving machinery, equipment and supplies for certain narrowly restricted manufacturing and mining purposes.<sup>140</sup> The requirement is that prior to repossession, the conditional vendor or his assigns first tender to the vendee the payments made on the contract after deducting reasonable compensation for the use of the property, which shall not exceed fifty per cent of the amount paid. No refund is required, however, unless it exceeds twenty-five per cent of the contract price. Thus, there is another reason, in addition to those cited above with respect to chattel mortgages, all of which apply with the same force to conditional sales, why the UTRA is greatly to be preferred over the conditional sale as a secured inventory financing device.

The problem presented by the existence of trust receipt security covering goods which become the subject of retail financing, is the same for the purchaser of retail conditional sale paper as in the case of the purchaser of chattel mortgage paper.<sup>141</sup> Likewise, the hazard of subsequent lienors under section 1316.30 is also present.

### *Factor's Lien*

The Factor's Lien Act,<sup>142</sup> which has been in effect since October 12, 1945, parallels the UTRA as an effective method of inventory financing.

<sup>138</sup> Under the pre-existing case law of Ohio, it would seem that all of these liens would be inferior to a chattel mortgage on file prior to the time the lien arose. Metropolitan Securities Co. v. Orlow, 107 Ohio St. 583, 140 N.E. 306 (1923); 9 OHIO JUR.2d *Chattel Mortgages* § 106 (1954).

<sup>139</sup> *In re Chas. M. Ingersoll Co.*, 222 F.2d 120 (6th Cir. 1955).

<sup>140</sup> OHIO REV. CODE § 1319.14 (Baldwin 1958).

<sup>141</sup> The capital loan transaction considered earlier under chattel mortgages is not considered because it would be highly unusual and undesirable to cast such a transaction in the form of a conditional sale.

<sup>142</sup> OHIO REV. CODE §§ 1311.59-.64 (Baldwin 1958).

Especially designed for the creation of a lien on a floating stock of merchandise<sup>143</sup> held by the borrower for manufacture or sale, this law has received surprisingly little use<sup>144</sup> or attention.<sup>145</sup>

The mechanics set up under the act for perfecting a factor's<sup>146</sup> lien are quite similar to the procedure under the UTRA. The borrower and the factor must enter into a written agreement providing for the lien on such merchandise of the borrower as is from time to time thereafter designated in separate written statements.<sup>147</sup> A notice of the factor's lien, setting forth the names and addresses of the parties, the date of the written agreement and the period of time during which loans may be made against the merchandise, must be filed within fifteen days after the execution of the written agreement.<sup>148</sup> The lien is perfected from the time of filing the notice whether the merchandise is in existence then or comes into existence later. Three years is the duration of the notice and it can be extended for an additional three years by refiling within thirty days prior to the expiration date.<sup>149</sup> Protection equivalent to that found

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<sup>143</sup> " 'Merchandise' means materials, goods in process, and finished goods intended for sale, whether or not requiring further manufacturing or processing, but does not include motor vehicles, whether or not intended for sale, or machinery, equipment, or trade fixtures of the borrower. . . ." OHIO REV. CODE § 1311.59(A) (Baldwin 1958). Note the unfortunate use of the last comma following "equipment" which might be urged (but, it would seem, erroneously) as indicating that all "machinery and equipment," whether or not capital assets of the borrower, are excluded from the act.

<sup>144</sup> During 1956 and 1957, thirteen and thirty-three, respectively, notices of factor's lien were filed in Cuyahoga county. For the twelve-month period ending August 23, 1958, only twenty-four notices of factor's lien were filed as compared to 473 filings under the UTRA.

<sup>145</sup> There is only one reported decision in which this law was involved. *In re Wyse Laboratories, Inc.*, 55 Ohio L. Abs. 321 (S.D. Ohio 1949). It has been discussed, however, in several articles. See Cameron, *Factors' Liens in Ohio*, 23 OHIO BAR ASS'N REP. 361 (1950); Ogline, *The Factors' Lien Act as a Method of Inventory Financing*, 4 W. RES. L. REV. 336 (1953). See also Freedheim and Goldston, *Article 9 and Security Interests In Instruments, Documents of Title and Goods*, 15 OHIO ST. L.J. 51, at 57 (1954).

<sup>146</sup> "Factor" is broadly defined to mean anyone advancing money on the security of merchandise whether or not employed to sell such merchandise. OHIO REV. CODE § 1311.59(B) (Baldwin 1958).

<sup>147</sup> OHIO REV. CODE § 1311.60 (Baldwin 1958). In the *Wyse* case, *supra* note 145, the original written statement describing the merchandise apparently contained a broad provision covering after acquired merchandise. The court held that the factor's lien was valid as to such after acquired merchandise without the necessity of obtaining an additional written statement from the borrower when the merchandise subsequently came into the borrower's possession.

<sup>148</sup> OHIO REV. CODE § 1311.61 (Baldwin 1958). Filing must take place in the county where the borrower has his "principal place of business," which in the case of a corporation is governed by the records of the Secretary of State, or if he has no place of business in the state, then where the merchandise is located. *Cf.* OHIO REV. CODE § 1316.23 (Baldwin 1958).

<sup>149</sup> OHIO REV. CODE § 1311.63 (Baldwin 1958). It has been pointed out that it is questionable whether this section permits only a single extension of the term of

in the UTRA is provided for purchasers in the ordinary course of business and the holders of liens arising out of contractual acts of the borrower in preparing the merchandise for sale.<sup>150</sup>

The Factor's Lien Act is broader in scope than the UTRA, not being restricted to a transaction whereby there is a new delivery of goods to the borrower.<sup>151</sup> An old stock of merchandise, as well as a new one, can be made subject to a factor's lien. Moreover, in the case of a new delivery where the Factor's Lien Act and the UTRA afford alternative methods of financing, there is one important feature of the former which may commend its use in preference to the latter. The factor's lien is a broad floating charge on all merchandise of the borrower designated by the written statements, which secures all the loans and advances made during the period specified by the written agreement. This is not the case under the UTRA where it is specifically provided that the entruster's security interest pursuant to a trust receipt designating the goods delivered to the trustee extends to the new value given as a part of the transaction but not to past indebtedness or future obligations of the trustee.<sup>152</sup> Thus, the factor has the considerable advantage of looking to the borrower's entire inventory as security for any one of a number of separate advances, whereas the entruster cannot enjoy the benefits of cross security.<sup>153</sup>

On the other hand, the UTRA confers certain important benefits on the secured party which would not accrue to him as the holder of a factor's lien. Foremost among these is the right to the debt, proceeds or value of proceeds resulting from a sale of the goods by the trustee. Also, the entruster enjoys the thirty-day grace period with respect to filing and a greater degree of protection as against subsequent claimants of security interests where there is a failure to file after the thirty-day period. The rights of the entruster to sell goods on default are clearly spelled out<sup>154</sup> while the Factor's Lien Act is silent on the subject.

The lender engaged in inventory financing governed by Ohio law should keep well in mind the area in which the factor's lien can be

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notice of factor's lien or repeated extensions. See Freedheim and Goldston, *supra* note 145, at 58. However, the same problem would seem to be present under OHIO REV. CODE § 1316.27 (Baldwin 1958) with respect to the filing of a trust receipt statement; which is good for only one year as compared to three years for the notice of factor's lien.

<sup>150</sup> OHIO REV. CODE § 1311.62 (Baldwin 1958). The language as to liens is the same verbatim as that appearing in § 1316.21.

<sup>151</sup> Cf. OHIO REV. CODE § 1316.02(A) (Baldwin 1958) defining the scope of the UTRA.

<sup>152</sup> OHIO REV. CODE § 1316.28 (Baldwin 1958).

<sup>153</sup> The entruster is so limited only "as against purchasers and creditors," so presumably as between the entruster and the trustee cross securing all advances by the goods described in various trust receipts would be enforceable. However, this means little because it is generally only in the context of insolvency that the extent of the security interest becomes important.

<sup>154</sup> OHIO REV. CODE § 1316.13 (Baldwin 1958).

used where the trust receipt cannot, and, furthermore, should weigh the relative merits of the two acts in deciding which to use in a situation where they constitute alternative security devices. Where the goods to be financed consist of a large number of relatively inexpensive items (which, as a practical matter, has the effect of substantially reducing the importance of the entruster's rights under the UTRA to debt or proceeds created by sale) the lender may well find that he is better off taking the "floating" factor's lien.

Any person intending to lend money on the security of a factor's lien, just as in the case of a chattel mortgage, should be on the alert for the outstanding trust receipt unaccompanied by the filing of a statement.

#### *Assignment of Accounts Receivable*

Rights to the payment of money arising from the sale of goods are covered by both the Assignment of Accounts Receivable Act ("Receivables Act"<sup>155</sup>) and the UTRA. Each act grants to a different person the right to claim the obligation representing the unpaid purchase of goods. Under the Receivables Act it is the protected assignee asserting his right to the account receivable assigned to him by the assignor; under the UTRA it is the entruster asserting his right to the debt or proceeds created by the sale of goods by the trustee.<sup>156</sup>

The conflict is analogous to the problem considered above with respect to rights to retail chattel mortgage or conditional sale paper emanating from a sale of goods subject to a trust receipt, but in this instance the proper conclusion would appear to be rather clear-cut in favor of the entruster. This is due primarily to an express provision of the Receivables Act which subordinates a protected assignee to the rights of a person who, at the time of sale of the property from which the receivable arose, had a valid lien on the property by way of pledge, chattel mortgage, *trust receipt* or other lien, to the extent that the law gives such person priority over an assignee.<sup>157</sup> Since sections 1316.19 and 1316.20 extend the entruster's security rights to the debt or receivable resulting from a sale of goods by the trustee, the entruster should occupy the preferred status provided by the Receivables Act. Moreover, the assignee is not in a position to claim that he is superior to the entruster under section 1316.16 because, clearly, accounts receivable are not "instruments in such forms as are by common practice purchased and sold as if negotiable."

It is even more difficult than in the case of retail paper to be certain of the effect that a failure to have filed a statement may have on the rights of the entruster in a contest with the assignee of accounts receivable. Under section 1316.20, the entruster is entitled to the debt and proceeds of the goods "to the extent to which and as against all classes

<sup>155</sup> OHIO REV. CODE §§ 1325.01-.08 (Baldwin 1958).

<sup>156</sup> OHIO REV. CODE §§ 1316.19, .20 (Baldwin 1958).

<sup>157</sup> OHIO REV. CODE § 1325.04(C) (Baldwin 1958).

of persons as to whom his security interest was valid at the time of disposition by the trustee," but the assignee of the receivable doesn't seem to fit within any of the classes of persons whose rights as against the entruster in the absence of filing are delineated. There would seem to be no possibility of the assignee prevailing over the entruster where the former takes an assignment after filing of the entruster's statement or with notice of the latter's rights. At the other extreme, it would seem that the assignee should prevail if he takes the assignment without notice in the absence of the filing of a statement by the entruster and subsequent to the thirty-day period. The result of the in-between situation where the assignee perfects an assignment during the thirty-day period but before filing by the entruster is the most difficult to predict.

In any event, the prudent assignee of accounts receivable before advancing funds to the assignor will want to be certain that a search of the trust receipt index as of a date at least thirty-one days after delivery of the goods to the assignor reveals no statement designating his assignor as trustee of such goods.

It is interesting to note in passing the contrast between the UTRA and the "Receivables Act" with regard to the duty imposed upon the secured party to police the borrower's obligation to account for proceeds. Under Ohio Revised Code section 1325.06, the protected assignee is specifically relieved of any responsibility to prevent the assignor from dealing with the proceeds as his own property. The entruster, however, under section 1316.20(c) is deemed to have waived his rights to the proceeds if he fails within ten days of gaining knowledge of the existence thereof to demand an accounting.

#### *Bulk Sales*

As has been mentioned earlier, an entruster's security interest in goods is valid as against a transferee in bulk unless the latter in good faith and without notice gives value after the thirty day filing period and obtains delivery of the goods from the trustee prior to the filing of a trust receipt statement.<sup>158</sup>

The general subject of bulk sales is covered under Ohio Revised Code sections 1313.53 et seq. Although the Bulk Sales Act does not touch upon the rights of secured creditors of the seller in bulk, as regards their security, it is important to appreciate the interrelation of this act and the UTRA.

Of primary significance is the fact that the two laws contain different definitions of a bulk sale. A transferee in bulk is defined under the UTRA to mean "a mortgagee, pledgee, or buyer of the trustee's business substantially as a whole."<sup>159</sup> The Bulk Sales Act by its terms applies to

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<sup>158</sup> OHIO REV. CODE § 1316.18(B)(2) (Baldwin 1958).

<sup>159</sup> OHIO REV. CODE § 1316.01(M) (Baldwin 1958) (Emphasis added.).

the sale, transfer, or assignment, in bulk, of *any part or the whole* of a stock of merchandise, or merchandise and the fixtures pertaining to the conducting of said business, or the sale, transfer, or assignment in bulk *of the fixtures* pertaining to the conducting of said business, otherwise than in the ordinary course of trade and in the regular and usual prosecution of the business of the seller, transferor, or assignor. . . .<sup>160</sup>

Hence, at the outset it should be recognized that a transaction might be considered a sale in bulk under the UTRA but not under the Bulk Sales Act, and vice versa.<sup>161</sup> The most obvious incongruity is the express inclusion of a mortgagee and pledgee under the UTRA definition and the judicial exclusion of the same from the Bulk Sales Act,<sup>162</sup> but the difference in the language of the two statutes with reference to the extent of the assets of the business which must be acquired from the owner in order to constitute a bulk sale should also be carefully noted.

The purchaser of assets in bulk, unlike ordinary purchasers, must take protective measures to safeguard his rights against general creditors of the seller. This involves complying strictly with the provisions of the Bulk Sales Act. Briefly stated, the requirements are that the purchaser (1) demand and receive from the seller a written list of the seller's creditors stating the amount due each and certified under oath by the seller to be an accurate and complete list of his creditors and indebtedness, (2) at least five days before taking possession of the assets or paying therefor, notify each creditor so listed, or of which the purchaser has knowledge, of the proposed sale, price and terms thereof, and (3) obtain from the seller a certificate from the county treasurer showing all taxes to have been paid.<sup>163</sup> If a purchaser does not comply with these requirements, any creditor of the seller within ninety days after the sale may hold such purchaser accountable to creditors for all assets which were the subject of the sale.<sup>164</sup>

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<sup>160</sup> OHIO REV. CODE § 1313.54 (Baldwin 1958) (Emphasis added.).

<sup>161</sup> If the buyer is not within the definition of transferee in bulk, he can defeat the entruster's rights even if he purchases goods within the thirty-day period provided he gives new value and obtains delivery from the trustee prior to filing of the statement. OHIO REV. CODE § 1316.18(B)(1) (Baldwin 1958).

<sup>162</sup> Winters Nat'l. Bank & Trust Co. v. Midland Acceptance Co., 47 Ohio App. 324, 191 N.E. 839 (1934) (neither the giving of a chattel mortgage nor taking possession of property thereunder is a sale, transfer or assignment under the Bulk Sales Act).

<sup>163</sup> OHIO REV. CODE § 1313.54 (Baldwin 1958). Under OHIO REV. CODE § 5739.14 (Baldwin 1958), the additional duty is imposed on the purchaser of a business to determine from the Department of Taxation the amount of accrued sales tax owed by the seller and to withhold from the purchase price the amount thereof. A purchaser who fails to comply becomes personally liable for the taxes accrued during the operation of the business by the seller. State v. Sloan, 164 Ohio St. 579, 132 N.E.2d 460 (1956).

<sup>164</sup> OHIO REV. CODE § 1313.55 (Baldwin 1958). The ninety-day statute of limitation does not apply to a claim against the purchaser for unpaid taxes of the

Although at times burdensome, a purchaser in bulk can by complying with the provisions of the Bulk Sales Act gain complete protection from the claims of the seller's general creditors. However, this gives the purchaser no assurance with respect to secured claims against the assets purchased of which he has actual or constructive notice.

Prior to the adoption of the UTRA, a search of the pertinent records in the county recorder's office immediately preceding payment of the purchase price was all that was required to assure the purchaser of the absence of encumbrances or liens affecting the merchandise or fixtures being purchased. That this is no longer true is made perfectly clear by the provisions of the UTRA which, in the absence of the filing of a statement, govern the rights of the transferee in bulk as against the entruster. The result under section 1316.18(B)(2) is that an entruster who has filed no statement will prevail over an innocent transferee in bulk in every instance except where the transferee gives value *more than* thirty days after the goods were delivered to the seller in bulk and, before filing, also obtains delivery thereof.

Thus, there is only one way that the transferee in bulk who innocently purchases goods subject to a trust receipt can defeat the claim of the entruster. He must wait before paying the seller until thirty days have passed following an inventory of the seller's stock of goods (unless he receives satisfactory evidence that the seller has been in possession of the goods for over thirty days) and then, finding no entruster's statement on file, must immediately take possession of the goods.<sup>165</sup>

#### CONCLUSION

The enactment of the UTRA constitutes a highly significant development in the Ohio law governing commercial transactions. As has been seen, its effect upon financing transactions extends beyond the subject of trust receipts. Thus, it is highly important for all persons engaged in the field of secured financing to develop a general awareness of the provisions of the UTRA and their far-reaching consequences. One may not choose to ignore the act simply because he has no intention of using the trust receipt as a security device.

The UTRA should prove to be a valuable addition to the body of

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seller. The Bulk Sales Act provides no remedy for the creditor who has received within the time prescribed a copy of the notice of bulk sale and is fearful that his debtor will dissipate the cash proceeds of sale.

<sup>165</sup> The unsuspecting transferee in bulk is better off than the innocent chattel mortgagee or taker of some other security interest because in the ordinary course of events he will obtain delivery of the goods at or shortly after the payment of the purchase price while the holder of the security interest will generally permit possession to remain with the debtor. On the other hand, the taker of a security interest is protected even within the thirty-day period if he gives new value and obtains delivery whereas the transferee in bulk is never protected if he makes payment within the thirty-day period.

Ohio commercial law. Despite its newness it is already in extensive use and it is felt that as the trust receipt and the provisions of the UTRA become more familiar to lawyers and their clients throughout the state, the act will provide an ever increasing stimulus to inventory financing. By making credit more readily available in the field of inventory financing the UTRA should benefit the economy.

The act is not without drawbacks. It is by far the most complicated of Ohio laws on secured financing. A number of its provisions are unclear and might give rise to controversy and litigation, although it is surprising that the number of reported decisions on the UTRA from other states is extremely small. The departure in a few respects from well established principles of Ohio law is regrettable.

Nevertheless, the UTRA bridges a gap in the pre-existing law and represents a stride forward in the direction of a more modern and complete set of commercial laws which may culminate in the adoption by Ohio of the Uniform Commercial Code.