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PRINCIPLES GOVERNING THE DISTINCTION BETWEEN CONDITIONAL SALES AND CHATTEL MORTGAGES

· *By* RAYMOND YOUNG

In the present era of vast and tremendous business enterprise, when property is being transferred with a rapidity which would have caused a numbing confusion among merchants of past years, when credit is extended and indebtedness secured largely by property, when judgments are rife and execution levied upon property to an extent quite unprecedented, it behooves one who sells property to know wherein protection of his interests in property sold may best be had.

In general, limiting our field to the sale of personalty, there are two kinds of security: the conditional sale and the chattel mortgage. Though different in their nature, these two forms are often difficult to distinguish one from the other. The digests and reporters fairly bristle with cases decided by the courts where the sole question presented was whether the instrument before them was a mortgage or a conditional sales contract. It is from the cases that certain general principles have been evolved which have subsequently aided the other courts when presented with the delicate question of construing these instruments and determining in which class the instrument rightly belongs.

To a complete understanding of this somewhat involved distinction, it is not only advantageous but extremely necessary that we leave behind us a Daedalian cord so that as we proceed into the labyrinth we may retrace our mental advance and determine its course. Nothing could serve better as such a "cord" than a simple workable definition of the two forms of security.

A conditional sale is, as its name implies, one in which the buyer is to perform some condition, precedent or concurrent, before the title becomes complete in him, the title meanwhile remaining in the seller. For the purpose of this treatise, the condition of the sale will be limited to that of payment of purchase price the definition then being a sale whereby the seller

delivers possession to the buyer but reserves to himself a title to the goods, until the whole amount due therefor is paid.¹

A chattel mortgage in some states retains its common law character and is looked upon as a sale of the subject matter, on condition subsequent, passing a legal title subject to be defeated by the condition upon which it is given.² But by the weight of authority a mortgage on chattels is regarded as constituting security, and creating a lien upon the subject matter.

From the above definitions it is apparent that a distinction must be made, for the nature of the seller's right must be ascertained before his remedy can be determined. The remedy in the case of a chattel mortgage is limited to foreclosure and sale, and in case they are insufficient to pay the amount due, a deficiency judgment. In the case of a conditional sale, the remedy of the seller is not only an enforcement of the contract, but he may sue in replevin to recover back the property.

All courts agree on the general proposition that at some point the seller in a conditional sales agreement is bound to make an election, either to admit title to be in the purchaser by suing for the balance due, or to bring the action in replevin thereby voiding the contract. The confusion results when the various courts attempt to determine at just what point the election has been made: the commencement of the action, the recovery of the judgment, or the execution of the judgment.

That, however, is a question not embraced within the purpose of this paper, and so, interesting as it is, a discussion of it must be laid aside in favor of this article.

At first blush it would seem that the distinction between the chattel mortgage and the conditional sale is clear cut and well defined, but unfortunately it is not so. It is natural that the seller in his zeal to protect his interests will attempt in the contract of sale to insert every conceivable provision designed, ostensibly at least, to insure his protection. As a result we have a hybrid instrument, partaking of the nature of a conditional sale and a mortgage. In such cases, and they are many, it becomes necessary for the court, before which the instrument comes, as a prelude to the ascertainment of the rights of the parties claim-

¹ Tiffany on Sales.

² II C. J. 398, Chattel Mortgages.

ing under it, to exactly determine the nature of the instrument. As stated by the writer of an exhaustive note on the subject of conditional sales in American Lawyers' Report, "It is sometimes a close question to determine whether the contract is one of absolute sale without reservation of title by way of a chattel mortgage, or a conditional sale with absolute reservation of title in the seller, with payment of the purchase price as a condition precedent to the passing title."

In the construction of such instruments the courts have evolved certain general rules of construction to be applied when future cases arise, in order that the task of differentiation may be facilitated.

As we would expect to find it, the principle primarily adopted by the courts in such cases is that usually applied in contracts: the ascertainment of the intention of the parties as to what they agreed is to be drawn from the terms of the instrument and also from the attendant circumstances. Even though the parties set out in the contract that the instrument is a conditional sale, the court is not bound by its provisions, as it considers them in connection with the attendant circumstances. "Form counts for very little," as said by one court. On the other hand even though the parties may treat the instrument as a mortgage and record it as required by the statute governing chattel mortgages, the court may entirely disregard their actions and declare the instrument to be a conditional sale.³

This general principle of determination of the intention of the parties is of course not peculiar to the law of sales or mortgages. It is a creature of the law of contracts and ramifies into all subdivisions of that subject.

There are however a few principles which grew out of this attempt by the courts to distinguish between these two classes of contracts:

1. If the transfer is intended to secure an existing indebtedness it is a mortgage; but if it is given upon an agreement to sell and delivery of property, the title being retained by the seller, subject to a condition subsequent, the transaction is a conditional sale.⁴

³ *Giebert v Nat'l. Cash Register Co.* 52 N. E. 22.

⁴ *Plumber v Shirley* 16.380. Also *Lumber v Woodward* 144 Ind. 335 where a reservation by a seller of a vendor's lien in an instrument of sale was held to create a chattel mortgage.

This rule appears to be questionable in view of the fact that the transfer in the case of a mortgage might also be coincident with the sale, in a case for example, where there is an absolute sale with a mortgage back. The test however has been applied in a great many jurisdictions.⁵

2. The test or principle most frequently adopted is that where the instrument is ambiguous or doubtful, the presumption is in favor of the mortgage and against the conditional sale. The reason for this presumption was stated very lucidly and clearly by the New York Court of Appeals, to be that "in case of a mortgage the mortgagor although he has complied strictly with the terms of the mortgage, still has his right of redemption, while in the case of a conditional sale, without strict compliance the rights of the conditional purchaser are forfeited."⁶ This test has frequently been applied.⁷

These two principles, together with the general principle of ascertainment of intention, seem to be the only rules which have anything of a unanimity in their application by the courts. Other rules have been evolved by judicial decisions which have been applied by the courts. One such rule has been applied by the court of Colorado. The rule is easy of application and appears to the writer to be one which might well be universally adopted. It is that "optional payment is essential to constitute the transaction a conditional sale; a contract that imposes an unconditional liability upon the vendee to pay the purchase price is an absolute and not a conditional sale."⁸ Where for example, the vendee has given notes for a balance due which import an absolute promise to pay the amount due, the courts which have adopted this rule would regard the contract as an absolute sale with mortgage back rather than a conditional sale, the reservation of title being merely a security for the payment of the debt.⁹ However, if the notes are in the form of chattel notes, that is, the notes on their face contain a statement of the transaction, it would seem that this would make the contract conditional. This question is an interesting one and the affirmative and the

⁵ Ill., N. Y., U. S., Ind. and others.

⁶ *Matthews v Sheehan* 69 N. Y. 585.

⁷ 43 So. 409 (Alab.), 19 Ia. 335, 55N. W. 711 (Wis.), 52 N. E. 22 (Ill.), 24 N. W. 369 (Minn.), 98 N. E. 322 (Ind.) 54 Miss: 90:

⁸ *Andrews v Bank* 20 Col. 313.

⁹ *Tufts v Beach* 44 Pac. 771.

negative of the proposition are upheld by two distinct lines of cases.¹⁰

These in general are the principles and rules, the results of numerous decisions of the courts which are applied in determining whether an instrument is a conditional sale or chattel mortgage.

In some jurisdictions the distinctions between these two devices have been abolished and any attempt to reserve title in the seller is construed to be a chattel mortgage.

In Texas the distinction has been abolished by a statute which declares that a contract of sale with reservation of title is a chattel mortgage.¹¹

In Kentucky a similar result was arrived at by judicial decision. The rule has prevailed there since 1886 that where there is a clause in a contract reserving title in the seller until payment, title passes to the buyer, the effect being an absolute sale with a mortgage back;¹² and this rule has prevailed in that state whenever the question arose in the courts.

A number of states have adopted what is known as the Uniform Conditional Sales Act, the purpose of which is to make uniform the laws governing the subject of conditional sales. In these states the distinction remains inviolate, and the rules and canons of construction must be applied as before.¹³

In other states rules, statutory and judicial, have been fixed governing the subject, most of the states providing for a filing for record of such contracts. A few states, notably Indiana, do not require recording of conditional sales although recording of chattel mortgages is required.

A rather unique provision is made in the statute of Maine which provides for the foreclosure of a conditional sale giving to the purchaser the right of redemption after sale.

The nature of the subject here treated does not admit of dogmatic rules applicable in all cases. Every contract must, to a greater or less degree, be governed by its terms and the surrounding circumstances attending the transaction. To at-

¹⁰ That the contract is conditional 139 N. W. 101. that the contract is merely for security 175 Pac. 746.

¹¹ Decisions under statute: 173 S. W. 184, 199 S. W. 843.

¹² I. S. W. 414.

¹³ This act has been adopted in Alaska, Arizona, Delaware, New Jersey, New York, and Wisconsin.

tempt to apply without qualification some general rule of law would be a violation of the intention of the parties and make for them a new contract. It has been for this reason the writer's aim to do no more than state the rules which the courts have recognized and applied in their attempts to administer justice to the parties before them.