

- MOTOR VEHICLES

CERTIFICATE OF TITLE AS NOTICE OF LIEN

Kennedy was the holder of a Michigan certificate of title to an automobile. The certificate named Kennedy as owner and stated that no liens or encumbrances against the car existed. To secure a loan, Kennedy executed a chattel mortgage on the car to a Michigan bank. Though the bank properly recorded the chattel mortgage on the day of its execution,¹ it failed to avail itself of the provisions of a Michigan statute under the terms of which automobile liens made subsequent to the time of original issue of the certificate of title could be made to appear on the certificate.² Possession of the car and of the unaltered certificate of title were retained by Kennedy. Two months after the execution of the mortgage, Kennedy sold the car in question to Bogda Motors, whose place of business is in Indianapolis. The car was delivered, and the certificate of title, showing no liens or encumbrances, was assigned. Bogda Motors gave full value, and was without actual knowledge of the existence of the Michigan mortgage. Upon learning of the removal of the car from the state of Michigan in breach of the terms of the mortgage agreement, Nichols, standing in the shoes of the bank, brought this action to replevy the automobile in accordance with the mortgage provision authorizing the bank to take possession of the car in the event of Kennedy's failure to comply with the terms of the instrument. The trial court found for Bogda Motors. The Appellate Court of Indiana affirmed, declaring that the bank's failure to secure notation of its security interest upon the certificate of title precluded recovery. *Nichols v. Bogda Motors, Inc.*, 77 N. E.2d 905 (Ind. App. 1948).

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1. In accordance with the Michigan statute. MICH. COMP. LAWS § 13424 (Mason 1929).
 2. MICH. COMP. LAWS § 4659 (Mason Cum. Supp. 1945). Whatever may be the technical distinction between a "lien" and a "mortgage," the former word is used in this note as a generic term to comprehend those security devices which involve no change of ownership. "Lienor" and "mortgagor" are, therefore, here used interchangeably. The following language from the Michigan statute gives support to this rather free use of the terms: "Any lien made subsequently . . . where ownership does not change, shall become a part of the certificate of title by the filing with the Secretary of State, of an affidavit of the mortgagee that said lien has been placed upon the vehicle. . . ."

A valid automobile lien, which has been properly recorded in the state in which the lien was executed, will be enforced in a state into which the encumbered car is afterwards removed, if the removal is without the knowledge and consent of the lienor. This is declared to be the law in the great majority of American jurisdictions; it is said to obtain although the foreign lienor must try the strength of his security interest against bona fide purchasers or attaching creditors in the second state, notwithstanding the fact that the purchaser or creditor may have given full value, and may be without knowledge that a prior lien exists.³ The principle of comity, inducing a respect for the validly executed liens of a sister state, explains the apparent widespread adherence to the majority rule.⁴ The Indiana cases on the point indicate that this state is to be included in the majority.⁵ Both parties to the instant case conceded that such was the state of the law in this jurisdiction.⁶ The prevailing rule has the salutary effect of protecting, in each case, the out-of-state lienor whose debtor has defrauded him. At the same time, the rule has the extremely harsh effect of cutting off the rights of innocent purchasers and creditors who deal with the automobile in the state to which it has been removed. In defense of the rule, courts which apply it have said that the injustices which befall innocent purchasers are greatly outweighed by the benefits accruing to dealers in automobile paper.⁷

The Indiana Appellate Court did not apply the majority rule in the principal case; for, with us, apparently, the rule is to be invoked only in those cases in which the out-of-state

3. See *Mercantile Acceptance Co. v. Frank*, 203 Cal. 483, 265 Pac. 190, 192 (1928); *Ames Iron Works v. Warren*, 76 Ind. 512, 513 (1881); *General Motors Acceptance Corp. v. Nuss*, 195 La. 209, 214, 196 So. 323, 324 (1940); STUMBERG, *CONFLICT OF LAWS* 366 (1937); Beale, *Jurisdiction Over Title of Absent Owner in a Chattel*, 40 HARV. L. REV. 805, 810 (1927). Cf. RESTATEMENT, *CONFLICT OF LAWS* § 268, comment c (1934).
4. See *Forgan v. Bainbridge*, 24 Ariz. 408, 274 Pac. 155, 158 (1928); *Motor Investment Co. v. Breslauer*, 64 Cal. App. 230, 221 Pac. 700, 703 (1923); *Struble-Werneke Motor Co., Inc. v. Metropolitan Securities Corp.*, 93 Ind. App. 416, 427, 178 N. E. 460, 465 (1931).
5. See *Struble-Werneke Motor Co., Inc. v. Metropolitan Securities Corp.*, 93 Ind. App. 416, 427, 178 N. E. 460, 465 (1931); *Cable Co. v. McElhoe*, 58 Ind. App. 637, 646, 108 N.E. 790, 794 (1915).
6. See *Nichols v. Bodga Motors, Inc.*, 77 N. E.2d 905, 907 (Ind. App. 1948).
7. See *Metro Plan, Inc. v. Kotcher-Turner, Inc.*, 296 Mich. 400, 409, 296 N. W. 304, 307 (1941).

lienor has taken every step possible in the protection of his security interest.⁸ Here the mortgagee, in addition to the recordation of his lien, might also have secured (in accordance with a Michigan statute)⁹ notation of the mortgage on the mortgagor's certificate of title. Having failed to avail himself of this further statutory safeguard, the mortgagee must lose the protection which Indiana would otherwise afford him. A reluctance to cast a loss on an entirely innocent purchaser has led to the carving out of many exceptions to the majority rule, with the result that the decisions from courts purporting to follow the rule quite frequently protect the bona fide purchaser.¹⁰ The reasons those courts give for their divergences from the prevailing rule are often without a great deal of substance.¹¹ That criticism, it is submitted, can not be leveled against the court in the instant case, since it was the mortgagee's omission; in a very real sense, that led him into difficulty.¹² The decision in the instant case finds support, as well, in the attitude which Indiana courts have earlier manifested in similar cases, where the controversies involved no consideration of conflict of laws rules.¹³ The

8. See *Nichols v. Bogda Motors, Inc.*, 77 N. E.2d 905, 907, 908 (Ind. App. 1948).
9. See note 2 *supra*.
10. Prof. Leary of the University of Pennsylvania Law School has found that in 1947 probably not more than seven reported cases dealt with the general problem presented by the instant case. His examination of six of those cases, five of which were decided in jurisdictions wherein the majority rule is followed, disclosed that in four of the decisions the local purchaser was protected. Leary, *Horse and Buggy Lien Law and Migratory Automobiles*, 96 U. OF PA. L. REV. 455, 456, 457 (1948).
11. For example, in a recent case the court protected the domestic vendee, stating that inasmuch as the car had been removed from the lienholder's state before that unfortunate had recorded his security interest, there was at the time of recording no property within the state to which the lien could attach. Thus, the domestic purchaser was held to have acquired clear title to the automobile. *General Finance & Thrift Corp. v. Guthrie*, 227 N. C. 431, 42 S. E.2d 601 (1947). The reasoning employed by the court in the *Guthrie* case has been characterized as something akin to "medieval scholasticism." Leary, *supra* note 10, at 462. The same device appears in *Mosko v. Smith*, 179 P.2d 781 (Wyo. 1947) (but here there were other reasons for protecting the domestic purchaser). Cf. *Ames Iron Works v. Warren*, 76 Ind. 512 (1881).
12. Fox, had the mortgagee secured notation of his lien upon the mortgagor's certificate of title, as he might have under the Michigan statute, the certificate itself would then have been notice to any person subsequently dealing with the car.
13. Some of the earlier decisions are referred to in the principal case. See *Nichols v. Bogda Motors, Inc.*, 77 N. E.2d 905, 907 (Ind. App. 1948).

doctrine that an estoppel may be raised against a mortgagee in consequence of his having allowed the mortgagor to continue to deal in a certain fashion with the mortgaged property has been inveterate in the common law of this state.¹⁴ Indeed, the doctrine retains its vitality despite the enactment in 1935, of the Chattel Mortgage Act,¹⁵ which statute might have been supposed to be a repudiation of the common law learning.¹⁶

Questions of practical importance to Indiana dealers in automobiles and automobile paper are suggested by the situation presented in the instant case. Despite the disposition of courts to avoid the harshness of the majority rule as it applies to the purchaser, business conduct must be regulated in accordance with the classic statement of the rule. It is, at present, the only available guide. What, then, in the light of the prevailing rule, must be done by dealers in automobile paper and by dealers in automobiles to secure the protection of the law? The instant case suggests that the dealer in automobile paper may best protect himself by recording his security interest in accordance with whatever laws exist to aid him in giving notice to those who may subsequently deal with the encumbered car. Where the borrower has executed a chattel mortgage to his lender, the chattel mortgagee, it seems, has done all in his power to make his lien of record when he has complied with the filing provisions of the Chattel Mortgage Act.¹⁷ Our certificate of title act,¹⁸ unlike the Michigan one which figured in the instant case, makes no provision for official recordation on the certificate of encumbrances which attach after the *initial* issuance of the certificate.¹⁹ It is, of

14. *Indiana Investment and Securities Co. v. Whisman*, 85 Ind. App. 109, 138 N. E. 512 (1926); *cf.* *Guaranty Discount Corp. v. Bowers*, 94 Ind. App. 373, 158 N. E. 231 (1932); *LaPorte Discount Corp. v. Bessinger*, 91 Ind. App. 635, 171 N. E. 323 (1930). See Hewins, *Powers of Sale in Chattel Mortgages*, 15 IND. L. J. 506, 510 n.9 (1940).

15. IND. STAT. ANN. (Burns Supp. 1947) § 51-501 *et seq.*

16. *Helms v. American Security Co.*, 216 Ind. 1, 22 N. E.2d 822 (1939).

17. *Supra* note 15.

18. IND. STAT. ANN. (Burns Supp. 1947) § 47-2501.

19. A conditional sales contract will appear as an encumbrance on the certificate of title, since it has existence as a lien at the time of application for the certificate. Our statute on conditional sales omits provision for recordation of such contracts (when the thing conditionally sold is an automobile) in any other place. IND. STAT. ANN. (Burns Repl. 1943) § 58-801 *et seq.*

course, possible for the lienor to take up the borrower's certificate of title and to retain it until the lien is discharged. While retention of the certificate may be not without psychological effect upon the borrower, it is nevertheless true that if the borrower is determined to defraud his lienor he can easily do so by applying for and receiving from the State a new certificate to replace his "lost" one. Inasmuch, then, as our Chattel Mortgage Act provides the only positive means whereby a chattel mortgagee may record his interest, it must be concluded that a chattel mortgagee who complies with the terms of that statute has done all which the decision in the instant case would require him to do.²⁰

It seems to be true that some persons who deal in automobile paper are content to rely upon the good faith of the borrower. That is to say, the lender may omit filing his security interest for record, deeming the amount involved too small to justify litigation in the event of the borrower's decampment—and such a lender quite probably considers recordation useless unless litigation is contemplated.²¹ From what has been said, it is obvious that a lender who thus conducts himself does so at his peril.

What counsel can be given the dealer in automobiles? The instant case bears an implicit warning to, at least, the *first* purchaser in the state to which the encumbered car has been removed. A person so circumstanced is impliedly cautioned to buy no out-of-state car without first assuring himself that no liens exist against it in the state of its origin;

20. That is to say, compliance with the Chattel Mortgage Act of 1935 is all that the chattel mortgagee needs to satisfy the requirements of the instant decision with regard to the recordation of such a security interest. Presumably a mortgagee who had so recorded his lien would be protected as against purchasers or creditors in another state, assuming that the second state observed the practice of comity. Compliance with the terms of the Chattel Mortgage Act, however, does not furnish absolute assurance of protection. At least it has been held not to furnish such protection in an entirely intrastate transaction, where the mortgagee did not sufficiently restrict the use to which the mortgagor was allowed to put the property. *Helms v. American Security Co.*, 216 Ind. 1, 22 N. E.2d 822 (1939). The rule of the *Helms* case is adaptable to use by courts when called upon to adjudicate the rights of a domestic purchaser or creditor as against an out-of-state mortgagee. Inclusion in the mortgage of terms restricting the manner in which the mortgagor is to deal with the mortgaged property is a possible escape from the *Helms* case rule.

21. Banks, however, must apparently be characterized as circumspect in protecting their security interests. It is the custom of banks in Bloomington, Ind., to record chattel mortgages on the very day of the instruments' execution.

for, if such liens do exist and are recorded in accordance with the law of the state of origin, the interest of the foreign lienor will be paramount, notwithstanding the domestic purchaser may have given value and may have been innocent of knowledge of the prior lien.²² There is nothing harsh in that admonition. The foreign license plate and the foreign certificate of title with which the first purchaser is usually confronted give notice to him that the car recently has been brought from another state, wherein it may be subject to validly created liens. Possessed of this knowledge, the prospective purchaser can quickly and inexpensively put himself in touch with the appropriate authorities in the state of origin, and thus ascertain whether or not the automobile was removed from that state unencumbered. The operation of the majority rule can not be quarreled with when it casts the loss on an uninquiring first purchaser.

In only one area does adherence to the prevailing rule work real injustice. It is in the area in which a subsequent vendee of the first purchaser (or, the vendee of the absconding debtor, if the latter has secured license plates and title documents of the state to which he has removed the car) must lose the car or its value to the out-of-state lienor. The subsequent vendee usually buys the automobile after it has been re-registered in the state to which it has been removed. Thus, the car bears domestic license plates and a domestic certificate of title at the time of purchase by the subsequent vendee. Clearly he is entirely without notice of the existence of any prior lien, and would be at much trouble and expense to assure himself that he was receiving a clear title (inasmuch as only a search of the records of each of the forty-eight states would establish conclusively the non-existence of liens). It must be obvious that it is in this area that the exceptions to the general rule were born.

It is not the purpose of this note to suggest a means whereby protection may be extended alike to the lienor who assiduously records his security interest and to the genuinely innocent purchaser. That has already been exhaustively and excellently done.²³ Statutes looking toward a solution to

22. This, of course, merely restates the result which would follow an application of the majority rule.

23. Prof. Leary proposes a solution, the principal requirement of which is as follows: When application for a new certificate of title is made to the authorities of the state to which the car has

the problem are on the books in a few states.²⁴ Respecting the state of the law on the subject in Indiana, it can be said that the decision in the instant case helps to delimit the area in which the majority rule is to operate. The opinion warns, again, that the position of the purchaser of an encumbered out-of-state automobile is an unenviable and precarious one. If the result of the case is displeasing to the financing fraternity, it must nevertheless appear to that group that the decision is of value in that it points out what must be done by one who would adequately protect his security interest.

been removed, those authorities shall conduct an investigation to determine the existence of liens in the state in which the car is then registered. If liens are found to exist in the state from which the car has been removed, notation thereof shall be made on the new certificate of title.

This administrative determination of the existence of liens would obviously be more efficient and speedy if each state were to institute the scheme of central recording of automobile liens which Prof. Leary favors.

One contemplating purchase of a car which had been documented in a state in which the above system obtained would be at once apprised, by the certificate of title, of the existence of encumbrances. Protection of all parties dealing with the car could thus be effected. See Leary, *supra* note 10, at 475 *et seq.*

It would still be possible, of course, for the dealer in the second state to purchase an out-of-state car before it had been re-documented in the second state. In that situation, in the event of litigation between the lienor and the first purchaser in the new state, the statute which Prof. Leary favors would cast the loss on the first purchaser, for it would "provide that anyone dealing with a motor vehicle registered in another state would be subject to any encumbrances validly created by the law of such other state, or appearing on record there, unless he made application for and received an unencumbered title in his own state." Leary, *supra* note 10, at 479.

Recognizing that administrative errors might occur in obtaining and transcribing the information to be included in the new certificate of title, Prof. Leary suggests that an additional charge be made for the issuance of the new certificate. That money would become a sort of insurance fund out of which to compensate lienors who suffer because of such errors. Leary, *supra* note 10, at 480, 482.

24. See, e.g., UTAH CODE ANN., § 57-3a-80 *et seq.* (1943).