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SECURITY TRANSACTIONS AND THE CONFLICT OF LAWS

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While the new Certificate of Title Act [1] which was enacted by the Colorado legislature last year has eliminated many of the pitfalls of residents of this state who purchase or otherwise acquire interests in automobiles, it will have little effect in resolving the conflicts between interest acquired as a result of transactions occurring in Colorado and prior interests which arose in another state if the motor vehicles involved were registered in the other state. This conflict of laws problem still remains. This problem, of course, is not confined to interests in automobiles, but it may involve any chattel which is removed from one state to another. Discussion of the problem, however, is usually in terms of automobiles because they are the chattels in which rights have been asserted in most of the decided cases. This is true undoubtedly as a result of the comparative ease with which an automobile may be removed from one state to another.

A hypothetical case may serve to introduce the problem. Jones buys a car in State X either under a conditional sale contract wherein title is retained by the Brown Motor Company (the vendor) until all payments are completed, or by giving the Brown Motor Company a chattel mortgage to secure the unpaid balance, either type of transaction being recognized as valid under the law of State X. Thereafter, without the knowledge or consent of the Brown Motor Company, Jones removes the car to Colorado where interests in the car are asserted by attaching creditors of Jones, or by a subsequent purchaser, mortgagee, or other lien holder, each of whom acquired his interest without notice of the outstanding interest which was created by the out of state security transaction. The issue may be stated as follows: Will the Colorado courts recognize the interest acquired by Brown Motor Company by virtue of the transaction which took place in State X while the car was located in that state?

The issue thus presented should be carefully distinguished from the non-conflicts situation where the original transaction between Jones and Brown Motor Company took place in this state at a time when the car was situated here. In such an event, the Colorado courts should unquestionably determine the rights of the various parties in accordance with the internal law of this state.

[1] COLO. STAT. ANN., c. 16, § 13 (Supp. 1949). For a summary of this Act, see Hellerstein, *Certificate of Title Law Effective August 1*, 26 DICTA 175 (July, 1949).

COLORADO LAW APPLICABLE IN NON-CONFLICTS SITUATIONS

Before proceeding to an analysis of the conflicts situation presented in the hypothetical problem, it might prove helpful to consider momentarily some of the established rules of Colorado law which would be applied to conditional sales and chattel mortgages which had no contacts outside the state.

While there are significant differences in the nature of the rights which arise between parties to chattel mortgages on the one hand and parties to conditional sale contracts on the other hand,[2] the Colorado courts have held that regardless of whether the instrument used be a conditional sale contract, chattel mortgage, lease, trust deed, or other form, if it is intended to have the effect of a mortgage or lien upon the property, it must be acknowledged and filed for record. If this is not done, the property must be delivered to and remain in the possession of the vendor-mortgagee before his rights will be superior to those of third parties who, without notice, subsequently acquire an interest in the property.[3] While it may be doubted that conditional sales are "intended to have the effect of a mortgage or lien," [4] it is thus established that they do have that effect as to third parties who subsequently acquire rights without notice, and as to such third parties, they are given the effect of absolute or unconditional sales.

It should be noted that the above rules became established in reliance upon statutory provisions [5] no longer applicable to motor vehicles which are subject to the new Certificate of Title Act.[6] However, that Act, which requires the existence of any "mortgage" on a motor vehicle to be noted on the owner's certificate of title or bill of sale in addition to being filed for public record,[7] defines "mortgages" as including "chattel mortgages, conditional sales, contracts, or any other like instrument intended to operate as a mortgage or create a lien on a motor vehicle as security for an undertaking of the owner." [8] It may thus be inferred that the Act dealt only with the method of giving notice and left undisturbed the previous holdings which refused to differentiate between chattel mortgages and conditional sales with regard to the necessity of giving notice to third persons.

THE THEORY OF THE CONFLICT OF LAW RULE

If it be assumed that the above is a correct statement of the internal law of Colorado, it must be conceded that the law of most other states is different, particularly with reference to conditional

[2] HELLERSTEIN, CHATTEL MORTGAGES IN COLORADO, § 2 (3rd ed. 1940).
[3] Illinois Co. v. Patterson, 91 Colo. 391, 15 P. 2d 699 (1932); Coors v. Reagan, 44 Colo. 126, 96 P. 966 (1908). The chattel mortgage (or conditional sale) will, however, be valid as between the parties thereto, COLO. STAT. ANN., c. 32, § 4 (1935), or as to third parties with actual notice, COLO. STAT. ANN., c. 32, § 5 (1935).
[4] *See* Mr. Justice Butler dissenting in Illinois Co. v. Patterson, 91 Colo. 391, 408, 15 P. 2d 699, 705 (1932).
[5] COLO. STAT. ANN., c. 32, §1 and § 20 (1935).
[6] COLO. STAT. ANN., c. 16, § 13 (18) (Supp. 1949).
[7] *Ibid.*
[8] *Id.* c. 16, § 15(2)(m).

sale contracts, which, in the absence of express statutes to the contrary, are recognized as valid even against third persons without notice. As was pointed out by the dissenting justices in a Colorado case decided in 1932,[9] in the purchase of personal property, the rule of caveat emptor ordinarily applies. Thus, a lessee of chattels cannot, as against the lessor, pass title by sale thereof even to a bona fide purchaser who has no notice of the lessor's title. Nor can a bailee or agent by his wrongful sale pass title to a third person so as to cut off the interest of the bailor or principal.

Consequently, it may be supposed that under the law of the hypothetical State X, there is no statutory requirement for recording the conditional sale contract or chattel mortgage, or it may be supposed that there is such a requirement and that the instrument has been recorded in accordance with the law of State X. In either case, the result is the same, i.e. Brown Motor Company's interest is protected and superior to that of creditors of Jones, at least so long as the automobile remains in State X.

Upon the removal of the car to Colorado and upon assertion of rights therein by Jones' creditors or a subsequent vendee, it becomes necessary to choose between the law of State X and of Colorado. Except as a state may have to alter it to meet requirements of statutory or constitutional law, a state may select any choice of law rule which it wishes. However, the foremost objective of conflict of law rules is to prevent the outcome of litigation from varying solely because of the place chosen to institute the suit. This objective is dictated by reasons of fairness to all parties concerned. It will be conceded that this objective is not always attained; nevertheless, it is an objective which should be constantly in mind in the application of any choice of law rule.

There appears to be no constitutional compulsion that either the law of State X or the law of Colorado be applied in the problem at hand. While it has been urged by respectable authority that the state to which the chattel has been wrongfully removed has *no jurisdiction* to divest the owner of his interest in the chattel,[10] such a view has not found general acceptance. If the chattel is in the second state, that state has power over such chattel, and it seems that the second state can apply its own law to determine the interests of persons therein.[11] Nor does the Full Faith and Credit Clause [12] require the choice of State X law, there having been no judicial determination of the rights of the parties in that state.

It appearing that either choice of law is open to the Colorado court, the first step normally taken by the forum (Colorado) is that

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[9] Illinois Co. v. Patterson, 91 Colo. 391, 415, 15 P. 2d 699, 705 (1932).

[10] Beale, *Jurisdiction Over Title of Absent Owner*, 40 HARV. LAW REV. 805 (1927).

[11] *Compare* RESTATEMENT, CONFLICT OF LAWS, § 268 and § 275 (1934) for the suggestion that the interests of the mortgagee or conditional vendor are not divested as a result of any dealings in the second state but that dealings with the chattel in a state into which it is taken without consent of the mortgagee or conditional vendor may result in new liens which have preference over the mortgage or conditional title.

[12] U. S. CONST. ART. 4, § 1.

of *characterization*. This involves a determination of the legal nature of the problem. Is it one of tort, contract, property, etc.? The answer to this question will be determined by reference to the concepts of the forum. The problem at hand concerns interests in property which were created by contract. If the mortgagee or conditional vendor was trying to enforce a personal obligation created by the contract, a court where the action was brought might easily justify the conclusion that the legal nature of the problem was the validity of the contract, in which case the Colorado court would undoubtedly apply the law of the place of contracting,[13] State X.

Where, however, the controversy in the second state involves primarily claims of parties to interests in the chattel, as it does in this hypothetical situation, the courts will characterize the problem as one of property. The governing law then becomes the law of the state where the property was at the time of the transaction.[14] It may thus be seen that when the transaction took place in State X at a time when the property was located in that state, regardless of whether the problem was characterized as one of contracts or of property, the rights of the parties should normally be determined by the law of State X.

While this result is not reached because of any constitutional compulsion and rests upon principles of so-called comity, there is a great deal of merit in the rule. No state other than State X had any concern in the matter at the time the interests of the parties arose.

Conflict Cases in the Colorado Courts

The references to the usual choice of law rules in the preceding paragraphs should not be understood as expressing the choice of law rules usually applied in the Colorado courts. On the contrary, the decided cases in this state seem to indicate that the Colorado law differs in this respect from that of most other states.

The first reported conflicts case wherein this type of problem arose was *Harper* v. *People*.[15] In that case the court upheld the right of a conditional vendor against a domestic attaching creditor, the conditional sale contract having been entered into in Kansas. The court was careful to note a distinction between this conflicts case and an earlier non-conflicts case[16] wherein the conditional sale was made in this state. The court in the *Harper* case stated that wherever the *lex loci contractus* and the situs of the property unite to sustain the validity of the contract, "it may be safely asserted that it is enforceable in the courts of every state where a controversy arises over the title to the property."[17]

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[13] Cockburn v. Kinsley, 25 Colo. App. 89, 135 P. 1112 (1913).
[14] Restatement, Conflict of Laws, § 265 and § 272 (1934).
[15] 2 Colo. App. 177, 29 P. 1040 (1892).
[16] George v. Tufts, 5 Colo. 162 (1869).
[17] Harper v. People, *supra* at 179, 29 P. at 1040.

Similar treatment was given in a 1920 case [18] to a chattel mortgage on a truck which, although the sale and mortgage were executed in Colorado, was described in the mortgage as being situated in Nebraska. The chattel mortgage was valid in Nebraska, where it had been recorded, and it was therefore held valid and enforceable in Colorado, even though the facts indicated that the occasional removal to Colorado was with mortgagee's consent.

From these two cases, one might have concluded in 1920 that regardless of the conditions that the internal law of Colorado would have imposed upon the conditional vendor or mortgagee for the protection of his interest, if that interest had arisen as a result of a transaction in this state involving chattels here located, Colorado would respect similar interests which had arisen in a sister state and which were valid by the law of such state.

This seemingly harmonious state of affairs was soon shattered insofar as conditional sales were concerned, however, by the much discussed case of *Turnbull* v. *Cole*.[19] The facts in that case were that defendant's assignor had sold a car to one Keightley in Utah by virtue of a contract reserving to the vendor the right to take possession of the car upon default in payments and to sell it. The contract appeared to impose upon the purchaser an *unconditional* obligation to pay the agreed price; however, under the law of Utah, the contract was regarded as a conditional sale which did not pass title. Utah law did not require the recording of such a contract in order to protect the interest of the vendor. The car was subsequently removed from Utah without the knowledge or consent of the vendor, brought to Colorado, and sold to Bell, who mortgaged it to Cole to secure a note for $600.

In a 4-3 decision sustaining the interest of the subsequent mortgagee, Cole, the Colorado court said:

> . . . Contracts like that here under consideration, reserving a secret lien [20] to the vendor, will not be recognized as leaving title in the vendor, as against interested parties without notice. . . . The contract, though valid in Utah, could not be enforced in this state, because such action would be contrary to public policy, and would result in detriment to the interests of a citizen of this state. Both of these grounds furnish exceptions to the general rule of comity as applied to the enforcement of contracts.

It will be seen that the Colorado court here recognized that the "general rule of comity" would require the enforcement of contracts validly entered into in a sister state. The validity of the grounds for exception will be discussed later.

The case of *Turnbull* v. *Cole* was followed in two subsequent cases [21] wherein the rights of conditional vendors (arising in other states from transactions which, although unrecorded, were valid

[18] Flora v. Julesburg Motor Co., 69 Colo. 238, 193 P. 545 (1920).
[19] 70 Colo. 364, 201 P. 887 (1921).
[20] Emphasis added.
[21] American Equitable Assurance Co. v. Hall, 93 Colo. 186, 24 P. 2d 980 (1933); Commercial Credit Co. v. Higbee, 92 Colo. 346, 20 P. 2d 543 (1933).

by the laws of such states) were denied recognition. On the other hand, in the intervening case of *Mosko* v. *Matthews* [22] the Colorado court gave recognition to the interest of an Oklahoma mortgagee in a car which had been mortgaged in Oklahoma, the chattel mortgage being recorded in that state, and subsequently removed to Colorado without the knowledge or consent of the mortgagee.

Despite the language in these cases which indicated that the interests of the vendors were not recognized because conditional sale contracts create a "secret lien" which is against the public policy of Colorado, whereas the interest of a mortgagee who had recorded his mortgage would be recognized, it was urged that there was a more satisfactory explanation for the different treatment given in the Colorado courts to these two types of transactions. This explanation is well stated in the Colorado Annotations to the Restatement of Conflict of Laws as follows:[23]

> It is submitted that the rule of Turnbull v. Cole should be restricted to cases in which the conditional sale contract is not filed or recorded in the state of the original situs. There is no evidence . . . (that such) . . . contracts were so recorded. The danger of injury to citizens of Colorado is no greater in the case of a conditional sale contract recorded in the state of original situs but not in Colorado than in the case of a chattel mortgage recorded in the same way.

In the more recent case of *Castle* v. *Commercial Investment Trust Corp.*,[24] however, this seemingly logical explanation of the Colorado position was repudiated. There the conditional sale contract which had been executed in New York *was recorded* in New York. The subject of the sale, a car, was later removed to Colorado without the consent of the vendor plaintiff. In holding that a bona fide purchaser in Colorado had a claim superior to that of the New York vendor, the court was content to state that the comity rule does not extend to such a contract as the one there involved. Evidently the court found itself unable to support the position that the plaintiff had a "secret lien" which was repugnant to the public policy of Colorado, the conditional sale contract having been made a public record which was "notice to the world"; however, no other explanation was given for the decision.

The most recent Colorado case [25] dealing with a conditional sale contract entered into in another state shed no light upon the problem here under discussion, for there the Colorado purchaser from the conditional vendee had *actual* notice of the limited interest of the conditional vendee. The court, therefore, recognized the title of the conditional vendor.

Critique of the Colorado Position

From the foregoing discussion, it would seem that the following conclusions could be safely drawn from the Colorado cases:

[22] 87 Colo. 55, 284 P. 1021 (1930).
[23] Annotation to § 272 (1936).
[24] 100 Colo. 191, 66 P. 2d 804 (1937).
[25] Reavis v. Stockel, 120 Colo. ...., 208 P. 2d 94 (1949).

(1) The rights accruing to a mortgagee from a chattel mortgage executed in State X while the chattel was there situated will be recognized in Colorado even as against third parties without notice, provided that the mortgage was recorded in and valid under the law of State X. (2) The rights of the mortgagee in (1) above probably would not be recognized in Colorado if the mortgage was unrecorded in State X (even assuming that such a transaction was valid as against third parties by the law of State X) because of the Colorado abhorrence of "secret liens". (3) The title of a conditional vendor will not be recognized in Colorado as against third parties without notice where the conditional sale was executed in State X while the chattel was there situated even if the contract was recorded in and valid under the law of State X. (4) As between the contracting parties or as against third persons with actual notice, the rights accruing in State X to either a conditional vendor or mortgagee will be recognized in Colorado regardless of whether the contract was recorded in State X, provided such contract was valid according to the law of State X.

The primary quarrel that the writer has with the position of the Colorado courts concerns the second and third statements above, particularly the third. It should be remembered that in all the foregoing discussion, it was assumed that the removal of the chattel to Colorado was without the knowledge or consent of the vendor-mortgagee. The converse situation would clearly call for the result reached by the Colorado courts. The weight of authority is to the effect that, if the removal of the property to the second state *was contemplated* at the time of the contract, the vendor's title will not be protected as against persons who purchase the property in the second state in good faith from the vendee, or as against creditors of the vendee who levy thereon, after such removal, *unless* filed or recorded in the second state as provided by local law.[26] On the other hand, if the removal was not so contemplated, and if removal was without the knowledge or consent of the vendor, the courts in virtually all states, the notable exceptions being Texas,[27] Illinois,[28] and Colorado, afford protection to the vendor's title without the necessity of recording in the second state. The undesirable results of a contrary doctrine are clearly seen in the following passage by Professor Beale, referring to the Texas law, which is similar to that of Colorado:[29]

> It appears to be a regular course of business for a swindler to buy a motor car on credit in California or elsewhere, drive it into Texas, and sell or pledge it there. The original seller is helpless in the face of this practice; and Texas will doubtless continue full of willing bona fide buyers. That this result is most unfortunate from the point of view of commercial practice is clear.

[26] See collection of cases in 25 A.L.R. 1153 at 1158 (1923).
[27] Consolidated Garage Co. v. Chambers, 111 Tex. 293, 231 S.W. 1072 (1921)
[28] Judy v. Evans, 109 Ill. App. 155 (1903).
[29] Beale, *Jurisdiction Over Title of Absent Owner,* 40 HARV. LAW REV. 805, 810 (1927).

The right of Colorado to maintain a public policy against the use of conditional sales contracts in purely local transactions is not open to question. There are other states having a similar local policy; however, even in those states, the position is generally taken that, notwithstanding the local rule on conditional sales, where the contract is entered into in another state in which it is valid and has the effect of reserving title, it may be enforced in the forum, and such reserved rights will be superior to those of a subsequent purchaser from the vendee.[30]

When there is an attempt to apply this doctrine not only to local transactions, but also to the valid transactions in other states, entirely different considerations are present. Mere dissimilarities in the law of the forum and that of State X do not alone justify the refusal to enforce a valid foreign right. In the words of Justice Cardozo,[31]

> The courts are not free to refuse to enforce a foreign right at the pleasure of the judges, to suit the individual notion of expediency or fairness. They do not close their doors unless help would violate some **fundamental principle of justice, some prevalent conception of good morals,** some **deep-rooted tradition of the common weal.**[32]

This sense of obligation was expressed by a Colorado court in *Harper* v. *People, supra* as follows: "The contract will not be deemed to be opposed to the policy of this state unless based on immoral or criminal considerations."

Is it a violation of a fundamental principle of justice to recognize the title of a conditional vendor when that title is valid by the law of the only jurisdiction in which he has knowingly permitted the property to be present? Is there any immoral or criminal consideration involved in such recognition? If the Colorado courts would relent in the future with respect to conditional sale contracts that were recorded in a sister state, should they not also recognize the title of conditional vendors acquired in other states wherein the law did not require recordation of such interests? Would it be a violation of the deep-rooted tradition of our commonweal to recognize the title of a conditional vendor from State X (where the law does not require recordation) if our courts had determined to recognize the title of a conditional vendor from State Y (where the law requires recordation)? Or is recordation in a foreign state only of dubious value in protecting Colorado citizens?

It is not to be inferred that a state such as Colorado should disregard the welfare of its citizens who deal with non-residents. It is submitted, however, that any attempted distinction between out-of-state chattel mortgages and out-of-state conditional sales

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[30] Security Sales Co. v. Blackwell, 9 La. App. 651, 120 So. 250 (1928); Fry Bros. v. Theobold, 205 Ky. 146, 265 S.W.489 (1924); Barrett v. Kelley, 66 Vt. 515, 29 Atl. 809 (1894).

[31] Loucks v. Standard Oil Co., 224 N.Y. 99, 120 N.E. 198 (1918).

[32] Emphasis added.

contracts, when both are recorded in the other state, relates only to minor morals of expediency and debatable questions of internal policy. It is further submitted that recordation in a distant state, where the transaction is valid by both the *lex loci contractus* and the law of the situs of the property, is of doubtful value in protecting Colorado citizens.

One method by which states have afforded a measure of protection to their citizens is exemplified by section 14 of the Uniform Conditional Sales Act by which the reservation of title in the vendor is void as to certain purchasers and creditors, when the property is removed into another state, unless the vendor, within ten days *after he has received notice of the removal,* records the contract in the state to which the goods have been removed. This principle could be extended so as to apply to chattel mortgages. A second type of protection is found in statutes which give certain classes of lien holders, i.e. repairmen, priority over the title of the conditional vendor. Doubtless there are numerous other measures which a state may adopt for the protection of its citizens, and yet be consistent with a sense of fairness to citizens of other states. But to refuse recognition to rights arising out of certain types of transactions in other states merely because we would prefer the use of other types of transactions is to evidence a provincialism which has no place in our modern commercial life.

Exit Horatio (Laughing)

ANONYMOUS
of the Englewood Bar

In formal format, Dicta's slick
With *supra, ibid., et seq., sic;*
(Boy, those footnotes—fast and thick!)

'Smatter, pal, prefer confetti,
Arthur Godfrey, girls by Petty,
Milton Berle, and etty cetty?

No! Go read Popham, Creamer, Grossman,
Percy Morris and all of those men
Who're not exactly Billy Rose men.

'Twixt hydrogen and between uranium,
You'll need an up-and-coming brainium
(And you, with your ailing, run-down cranium!)

Sit up with Dicta at the midnight forge.
Horatio and I'll be with Gorgeous George.