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THE PRESENT STATUS OF BAILMENT LEASES IN PENNSYLVANIA

ALBERT M. HANKIN*

Once again bailment leases have come into the legal limelight in Pennsylvania, and again the legal profession was disappointed in its hope to have a final determination of the question as to whether a bailment lease would be regarded as a conditional sale, or as a true bailment in accordance with the form that a particular instrument might take.

Prior to the passage of the Conditional Sales Act on May 12, 1925, P.L. 603, sellers of merchandise, who desired to retain a lien thereon, used bailment leases and conditional sales agreements indiscriminately to effectuate that purpose. Since neither was required to be recorded, the subterfuge of the bailment lease was rarely used. The legislatures of most of the states of the union, including our own, realized the harm to the other creditors of those that bought merchandise on conditional sales, and passed acts requiring that conditional sales agreements be recorded if it was desired by the seller to retain a lien as against levying creditors of the buyer and innocent purchasers for value.

A typical situation intended to be corrected is as follows: A goes to B in order that he might purchase $5000 worth of equipment so that he can start a restaurant. B is anxious to sell to A, but is unwilling to take the risk of his solvency, and, therefore, enters into an agreement, whereby A would purchase the equipment conditionally, title to which would become absolute when the entire purchase price is paid, but if a default should occur in the payments which A is to make periodically, then title is to revert to B. It is apparent that under such an arrangement B would lose nothing. He generally receives a substantial down payment on account of the purchase price, and several installment payments. If later A becomes insolvent and cannot pay, or refuses to pay or is adjudicated a bankrupt, B has only to repossess the merchandise, and then resell it, sometimes for a price in excess of the unpaid balance.

A, however, having invested what capital he had as a down payment for the equipment bought from B, has now nothing with which to purchase foodstuffs, and so he is obliged to contact dealers of the various commodities needed, indicate that he is putting five thousand dollars worth of equipment into the enterprise and apply for credit to them. These dealers have no way of knowing or of ascertaining that the equipment is encumbered, and consequently extend the credit asked. If, subsequently, A defaults in his payments to B, or a levy is placed upon the assets of A, or he is adjudicated a bankrupt, then the various dealers learn for the

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first time that they have been virtually duped, and in such a manner that there is no method of recourse open to them. The Conditional Sales Act required that such agreements be recorded, if the seller was to retain a lien.

Persons subsequently extending credit to the buyer of the equipment on conditional sale have only to search the records to ascertain whether they are safe in assuming that the assets on the premises occupied by A are really his.

After the passage of the act, the other method frequently used to reserve title in the seller of merchandise was recalled, and the bailment lease was frequently resorted to, but whereas heretofore, no damage was occasioned by the interchanging of the two types of agreements, now that the legislative intention was to abolish secret liens, the harm was great. Of course it was argued that since the legislature did not include bailment leases in the requirement for recordation, that such omission was an indication that their use was to be permitted. However, when it is considered that many business enterprises are dependent on their ability to do a legitimate bailment business without the recording of each lease, the reason is obvious.

For example, X Company is engaged in renting automobiles by the hour or day. The total sum involved in many transactions might be only three or four dollars. The lessee of each automobile is required to execute a bailment lease agreement, and one can easily see that it would be impractical to require each such agreement to be recorded, even if the costs involved would not actually drive such a firm out of business.

The courts took cognizance of the situation, and early assumed the attitude that the form of the instrument was not the thing that governed, but rather that the intention of the parties controlled.1 For this there was ample authority, running back to the Statute of Elizabeth, which is law in this Commonwealth, and which branded secret liens of this character fraudulent.

If a vendor sells his property and delivers possession to the vendee, thus clothing him with all the indicia of ownership, it is a legal fraud on deceived innocent purchasers for value or execution creditors to attempt to reclaim the property because the purchase price has not, in whole or in part, been paid. The law abhors secret liens.2

Nevertheless, the real point involved was soon lost sight of in the many cases that arose, and because in some cases the courts refused to consider the agreement involved a bailment lease on the ground that it was defectively drawn, and indicated that a bailment lease to be effective at all had to have certain re-

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2Re Max Stein, Bankrupt, Eastern District of Penna. Cause No. 18825 (Dissenting opinion).
quisites, such as a provision for the return of the merchandise at the end of the term, it was mistakenly assumed, that thereafter if the agreement took the form of a bailment lease and was properly drawn, that it would be effective to retain title in the seller, although not recorded.

To lend weight to this contention, a number of cases were decided, in which the court determined that under the factual situation involved in each particular matter before it, that a bailment was intended. The resulting confusion which naturally followed was an enigma, both to the lawyer and to dealers in fixtures. There were many who refused to comply with the Conditional Sales Act, and chose to use the bailment lease as their method of reserving title. The law being in a status where the court hearing a case could decide either way by merely stating that the factual situation was such, that it warranted the finding that the transaction was in truth a bailment or a conditional sale as the case might be, resulted in many opinions, which though legally reconcilable, were actually conflicting.

Members of the bar reached the conclusion that the State Courts would almost invariably endeavor to find that the factual situation was that a bailment lease was intended, while in the Federal Courts, the tendency would be to the contrary. This continued until the Federal Circuit Court of Appeals for the Third Circuit by Judge Davis, on August 6th, 1936, handed down the decision in the case of General Motors Acceptance Corporation vs. Horton. This decision added momentum to the controversy already existing by indicating that the Federal Courts would hereafter favor the upholding of bailment leases. It assumed that the State Courts would in all cases consider a bailment lease, which was properly drawn, as effective in its intention to reserve title in the seller, and therefore felt obliged to follow the decisions of the State Courts in construing such contracts.

The case was, nevertheless, decided on the broad ground that the parties, under the facts involved, intended a bailment and not a conditional sale, although it indicated that the result might have been the same if the contrary intention existed.

It required no vivid imagination to anticipate the confusion which did, in the natural course of events, result. Proponents of the bailment lease contract claimed a complete victory and vindication of their position. Their opponents however, were far from satisfied. Firstly, because the case was based on the mistaken assumption that the State Courts were settled in their own views, and secondly, because the language on which the decision was based was merely dicta.

3Farquahr vs. McAlevy, 142 Pa. 233.
585 Fed. (2d) 452.
Several cases involving the question under discussion were, at that time, before the United States District Court for the Eastern District of Pennsylvania. Its constituent judges were themselves, either not harmonious or not clear on the question, as indicated by their previous decisions, and it was determined that all pending cases involving this question should be heard together by the court en banc. So it was that on the 21st day of December, 1936, the three cases involving bailment leases were argued before the four judges of the District Court. It immediately became apparent that the sole question was whether the Circuit Court by its decision had determined the question finally.

The majority opinion was written by Judge Maris in *Re Max Stein, Bankrupt*, on December 29, 1936, and was held to apply to the other cases presented. It cited *G.M.A.C. vs. Morton*, with approval and, at the outset, unequivocally stated that a bailment lease, in proper form would be effective to retain title in the seller, although it was based on the mistaken assumption that the Pennsylvania State Courts would always sustain a bailment lease contract in accordance with its form, regardless of the intention of the contracting parties, but then said:

"In the absence of evidence showing such a willingness, the form into which the parties have cast their transaction will be sustained."

This indicated to many that evidence could be adduced to contravert the intention as shown on the face of the written instrument, thereby raising an entirely different question, which the case did not decide.

Judge Dickinson dissented, and very pertinently pointed out why the cases used as authority for the majority opinion, and others reaching the same conclusion, were not binding.

"Judicial utterances are always to be read in the light of the fact situation to which they apply."

For the moment it may not be amiss to examine the cases decided by the State Courts, on which the majority opinion above and the opinion of Judge Davis rely. The case of *G. M. A. C. vs. Hartman*, decided by Judge Keller was one where an automobile was involved. Automobile encumbrances are governed by a special Act of Assembly, requiring their recordation. Judge Keller went to great pains to distinguish the case before him from those cases in which bailment lease contracts were not upheld, and said that they should be limited to their facts. He went on to discuss the situation at length and gave the impression that hereafter bailments would always be held sufficient to retain title in the seller. Yet using his own argument, and limiting the case which he decided, to its facts, it appears that the Motor Vehicle Act was really the

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6*Re Max Stein, Bankrupt*, supra.
7See note 5.
8See note 4.
91931, P. L. 751, Section 203 (a).
controlling factor; that the encumbrance in the case before him was recorded, and
that anyone who searched the records would have had notice of it.

Judge Keller in Braham & Co. vs. Surrell,\textsuperscript{10} himself perceived this distinc-
tion and so decided that case.

The situation, after all the legal wrangling, is still confused and the profes-
sion is still anxious for an illustrative case to be taken to the United States Supreme
Court. At this time, however, there do not appear to be any cases in which such
action will be taken. It is believed that if this were done, the fiction upon which
all decisions upholding bailment leases in effect as conditional sales would be dis-
pelled. It is felt that the Supreme Court would not tolerate the admission of a
certain state of facts together with the contention that the facts, nevertheless, were
not pertinent.

Although it is undoubtedly true that oral testimony cannot be adduced to
controvert the language of a written instrument, and although it is true that as
between the parties to the contract, the language used in the written instrument
is controlling, nevertheless, as against an innocent purchaser for value, a levying
creditor or a trustee in bankruptcy on whom a fraud would be perpetrated if he
were not allowed to go behind the language of the instrument to find the real in-
tention of the parties, such rules of evidence and of construction are not binding.\textsuperscript{11}

"Throughout the whole history of litigation there have been ingenuous at-
ttempts to elude the Statute of Elizabeth. Every device which professional ingen-
uiy could devise has been resorted to in vain. None of them have been permitted
to succeed."\textsuperscript{12} Will this situation be the exception?

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\textsuperscript{10}115 Super. 365.
\textsuperscript{11}Bank of North America vs. Penn Motor Co., 235 Pa. 194.
\textsuperscript{12}Re Max Stein, Bankrupt, supra (Dissenting opinion).