Automobile Financing in California as Affected by Registration

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Comment

AUTOMOBILE FINANCING IN CALIFORNIA AS AFFECTED BY REGISTRATION

A relatively new title device, the motor vehicle certificate of ownership or “pink slip,” has both simplified and complicated the California law of automobile financing. This discussion has set for itself the task of investigating to what extent the various uses of this document, and the statutory provisions which relate to it, have affected the law of secured transactions and creditors’ remedies.

The automobile registration requirements were originally devised to afford simple identification of ownership interests, thus aiding law enforcement and protecting purchasers’ rights. This function of identification also has simplified the forms of automobile financing and furnished, with varying degrees of certitude, a method of giving notice to others of the interests created in connection with finance transactions. Although the problems of
the various security devices are related, they will be treated separately here for purposes of clarity.

"White Slip" and "Pink Slip" Generally

With the exception of vehicles whose ownership is determined by the law of other states, substantially all vehicles to be operated upon the highways of this state must be registered with the Department of Motor Vehicles. Upon application for registration, the Department of Motor Vehicles issues two documents, the certificate of ownership, or "pink slip," and the registration card, or "white slip." Two documents are used because of the possibility of divided ownership. The person entitled to the beneficial use and possession of the vehicle is the "registered owner" or "owner" while the holder of a nonpossessory security interest by way of chattel mortgage or conditional sale is the "legal owner." If the "owner" has created no security interest, there is no division of ownership, and no "legal owner," the interests remaining united in the "owner."

While the holders of only certain security interests are required to be designated as legal owners on the certificate of title, the Department of Motor Vehicles actually lists as legal owner whomever it is asked so to designate when the certificates are sent in. Thus, an entruster in a trust receipt transaction can be, and frequently is, noted as legal owner. Since the lien of a pledge is dependant upon possession, there is no necessity for recording the pledgee as legal owner.

A dealer of new cars need not register the vehicles unless they will be moved on the highways before sale, and a used-car dealer need not reg-

1 CAL. VEH. CODE § 141. Section 142 lists the types of vehicles exempted from registration. Section 140 makes it a misdemeanor to move a vehicle of the type required to be registered, subject to exceptions in the code, and lists situations to which the section does not apply.

2 CAL. VEH. CODE § 151.

3 CAL. VEH. CODE § 68: "Registered owner" is a person registered by the department as the owner of a vehicle.

4 CAL. VEH. CODE § 66: "Owner" is a person having all the incidents of ownership, including the legal title of a vehicle whether or not such person lends, rents, or pledges such vehicle; the person entitled to the possession of a vehicle as the purchaser under a conditional sale contract; the mortgagor of a vehicle; or the State, or any county, city, district or political subdivision of the State, when entitled to the possession and use of a vehicle under a lease, lease-sale, or rental-purchase agreement for a period of 30 consecutive days or more.

5 CAL. VEH. CODE § 67: "Legal owner" is a person holding the legal title to a vehicle under a conditional sale contract, the mortgagee of a vehicle, or the renter or lessor of a vehicle to the State, or to any county, city, district or political subdivision of the state, under a lease, lease-sale or rental-purchase agreement which grants possession of the vehicle to the lessee for a period of 30 consecutive days or more.

6 CAL. VEH. CODE § 151.

7 CAL. VEH. CODE § 67, supra note 5, defines legal owner as chattel mortgagee, conditional vendor, or lessor of a vehicle to the state, or other political subdivision.

8 CAL. VEH. CODE §§ 175, 181.

9 Although CAL. VEH. CODE § 180.5 exempts an entruster holding the pink slip from applying for transfer, and specifically states that the Uniform Trust Receipts Law shall exclusively control the validity of the security interest, many entrusters are, nevertheless, noted as legal owner, when the vehicle is sold by a dealer on credit. See trust receipts infra.

10 CAL. CIV. CODE § 2988.

11 CAL. VEH. CODE § 141.
ister himself as owner with the department, but may endorse and deliver the pink and white slips directly to his customer.\textsuperscript{12} After the issuance of a certificate, a new car becomes a used vehicle within the meaning of the Vehicle Code,\textsuperscript{13} although purchaser and dealer will generally treat some, such as "demonstrators," as new cars in accordance with accepted trade practices. A new-car dealer may apply for and receive only a pink slip without registering the vehicle. This procedure requires payment of a $5.00 fee accompanied by an affidavit that the automobile has not been moved on the highways and will not be moved on the highways until registered with the department.\textsuperscript{14}

\textbf{Status of General Creditors}

The system of registration of automobiles in California has sometimes been compared with the Torrens System of land title registration.\textsuperscript{15} The resemblance is deceiving. Unlike the Torrens System,\textsuperscript{16} automobile registration in California is not conclusive of ownership interests and does not bar latent equities. Levying creditors have often been denied satisfaction out of automobiles registered in their debtors' names because of resulting trusts arising from payment for the vehicle by one other than the debtor.\textsuperscript{17} Transfers of possession for good consideration, though "ineffective" if not accompanied by transfers of registration, have likewise resulted in barring the creditor of the transferor from levying successfully on the vehicle under a writ of execution or attachment. As the debtor is usually estopped to invoke the statutory mandate for the purpose of asserting the invalidity of such transfer,\textsuperscript{18} it has been concluded that the creditor, standing in his

\textsuperscript{12} \textit{CAL. VEH. CODE} §§ 180, 177. The dealer must notify the department of all sales.

\textsuperscript{13} Since only vehicles moved on the highway are required to be registered, registered vehicles are "used" cars.

\textsuperscript{14} \textit{CAL. VEH. CODE} § 151.1.

\textsuperscript{15} See Comment, 39 \textit{CALIF. L. REV.} 396 (1951).

\textsuperscript{16} Land Title Law [Torrens Act] (Initiative 1914) \textit{Cal. Stats.} 1915, p. 1932. Before land is registered under the Torrens system, a judicial determination of title is made. The judicial decree ordering registration is a decree in rem quieting title and is conclusive of interests in the land.


\textsuperscript{18} \textit{CAL. VEH. CODE} § 186. This section formerly provided that no transfer of title to a motor vehicle would be effective without change of registration "... except as a transferor may be estopped by law to deny a transfer." The 1943 amendment to § 186 (\textit{Cal. Stats.} 1943, c.1129) deleted this statutory recognition of estoppel, but it appears no change in the law resulted. The supreme court, in WARNIN v. WARGIN, 29 Cal.2d 842, 845, 180 P.2d 349, 350 (1947) stated: "It may be assumed that the omission of the quoted provision in the section as it now reads did not change the law regarding the application of the principles of estoppel in proper cases."

In Henry v. General Forming, Ltd., 33 Cal.2d 223, 226, 200 P.2d 785, 786 (1948) the court stated: "... similar assumed violations of the Vehicle Code have never been deemed to affect the actual property interest in the vehicle where it was necessary in pertinent proceedings to determine the issues of title and right of possession."

In 1953 the Legislature amended Section 186 by adding the following subsection (c):

"(c) The conditions of subdivisions (a) of this section shall not apply to a transfer of a security interest in the interest of a legal owner of a registered vehicle when such security interest arises from a pledge of a conditional sale contract, lease agreement, rental agreement or chattel mortgage by a legal owner to such transferee." (\textit{Cal. Stats.} 1953, c. 784).
debtor's shoes, is also bound by such estoppel and can reach only the real, not the apparent, interests of his debtor. Conversely, a transfer complying with the registration requirements of the Vehicle Code may fail to cut off the creditor's rights in the vehicle if possession is retained by the debtor.

The cases involving general creditors seem to lead to the conclusion that neither the certificate of ownership nor possession alone is always determinative of creditors' rights. While it appears that a creditor of a transferee who has failed to comply with the registration requirements may rely on possession obtained for consideration, a creditor of a noncompliant transferor can safely rely only on both the certificate and possession. The California Supreme Court in a recent case stated: "... the plaintiff, as a general creditor of the defendant, is not one for whose protection the ownership registration requirements were intended." While this may be historically accurate, it should not be interpreted to deprive a creditor of protection under all circumstances. The Appellate Department of the Superior Court, Los Angeles County, reached a sound rule when it indicated by dictum that one who extended credit in reliance on his debtor's registration as owner should be protected.

Before turning to the secured transactions cases, mention should be made of the custom of many creditors to achieve a limited protection of their interest without entering into a formal, secured transaction, by merely retaining the debtor's pink slip. Because the department requires both the pink slip and the white slip before it will transfer the registered owner's interest, the creditor can prevent such a transfer by holding the pink slip. He can also forestall encumbrance by a mortgage, as notation on the pink slip is the means of perfecting an automobile chattel mortgage. There is, however, one fly in the ointment: the possibility of the duplicate pink slip fraud. By applying for a pink slip under the pretense of loss, the debtor can obtain a duplicate from the department and can use it in other trans-

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21 In Getz v. Whisenant, 93 Cal. App.2d 182, 208 P.2d 708 (1949), the District Court of Appeal held that the failure of consideration prevented the transferee from obtaining any interest in the vehicle and that therefore a prior creditor of the transferee could claim no interest. The early case of Redwine v. Trowbridge, 99 Cal. App. 762, 279 Pac. 666 (1929), denied recovery to the creditor when the transferee had given consideration, but the decision was based on the Vehicle Code at a time when title did not pass until the department acted. Inasmuch as the transferee is protected by the estoppel of the transferor, a creditor of the transferee could probably claim the same protection now that the statute is changed.
23 Willard H. George, Ltd. v. Barnett, 65 Cal. App.2d Supp. 828, 831, 150 P.2d 591, 592 (1944). "An exception to this rule would exist if plaintiff had extended credit to defendant in reliance on her ownership of the car, but the record negatives that possibility."
26 Cal. Veh. Code §§ 165, 175(c), 182.
actions, either secured or unsecured. Through legislative amendment, the danger of this fraud could be lessened by requiring a duplicate pink slip to be marked "duplicate," thus putting interested parties on notice of possible adverse rights in the vehicle. Should inquiry then reveal nothing, the person relying on the duplicate should take precedence over the creditor holding the original, since the latter has failed to enter into a secured transaction. Retention of the pink slip has many advantages for those who wish to take the above indicated risk, not the least of which is the saving in filing and clerical expense.

Status of Conditional Vendor and Vendor's Assignee

The absence in California of a general recording act relating to conditional sales of chattels, creates a variety of situations subjecting the holder of the security title to the risk of paramount intervening right. This is especially true if motor vehicles are the subject of conditional sale contracts because not all vehicles come within the ambit of the certificate system and because the system itself is not completely foolproof.

If the conditional vendor of a registered vehicle is a dealer, he is not the type of creditor who can achieve protection by merely retaining the pink slip. Not required to register himself as owner, he may simply endorse and deliver the registration card and the certificate of ownership, but by so doing he vests his vendee with indicia of title sufficient to transfer the vehicle and estop the vendor to assert title. The vendee might also encumber the vehicle to the vendor's prejudice, or an attaching creditor might obtain rights in it if in extending credit he had placed reliance on the vendee's possession as well as the pink slip. However, the conditional vendor is obligated by law to furnish his vendee at least the white slip. Since it is impossible to transfer the white slip without mailing an endorsed pink slip to the department at the same time, the only way in which a dealer may protect himself and comply with the law is to send both slips to the department. The documents will then be re-issued, the pink slip to the conditional vendor as legal owner, the white slip to the vendee.

Another situation in which the conditional vendor will not be protected is where a new vehicle (not subject to registration) is sold to a dealer, who then sells to a customer. In this case the courts protect the buyer in due course of business who purchases from the dealer and who later receives the proper certificates from the department.

A conditional vendor might even lose his security interest where a used car is sold on conditional sale to a dealer (the vendor retaining the pink slip), although the dealer's customer fails to obtain a properly endorsed

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27 The duplicate fraud can also be perpetrated by a secured creditor who is noted as legal owner on the pink slip. If he obtains a duplicate, he may transfer his interest to two different parties, once validly with the original and once fraudulently with the duplicate.


30 Both slips must either be sent to the department, or endorsed and delivered to the vendee in order to avoid liability for negligence. Cal. Veh. Code § 178.

registration certificate. This result seems to follow from the tendency of courts to favor the customer. Moreover, the general custom of dealers to retain the certificates and themselves send them to the department should relieve the customer of negligence, and make a decision in his favor appear to be fair.

This same custom, however, makes possible the perpetration of fraud upon a vendor's assignee because finance companies sometimes treat the pink slip as the sole muniment of title. An illustration of such possible fraud is found in Dennis v. Bank of America Assn. The automobile dealer in that case sold a used car to purchaser X, who endorsed the pink slip and left it with the dealer who purported to mail it to the department. The dealer then cleverly faked a conditional sale contract for the same car and, using the pink slip, discounted it with Bank Y. On default of the assigned fictitious sale contract, the bank claimed the automobile in the hands of purchaser X. The court held that the bank was not entitled to invoke Section 186 of the Vehicle Code, which at that time conditioned the passage of interests upon issuance of new certificates by the department after receipt of the properly endorsed old ones. The court stated that as an assignee of a nonnegotiable instrument, the bank succeeded to all the infirmities of the assignor, that the assignor-dealer was estopped because possession of the car was transferred to the purchaser, and that the dealer could not profit by his own fraud. The court was further impressed by the fictitious nature of the conditional sale contract which it viewed as an attempted transfer not accompanied by a change of possession as required by Civil Code Section 3440. The court stated that, conceding the sale to Purchaser X to be invalid, X would then be a creditor of the dealer for the amount of the purchase price and, as a creditor, the purported sale involving no transfer of possession as required by Section 3440 would as to her be void and ineffective. The court held admissible testimony of an official of the department showing the custom of dealers to handle the transaction for the purchaser. The evidence of this custom absolved Purchaser X of negligence. The statutory maxim, that as between two innocent parties the one making possible the fraud must bear the loss, did not aid the bank. The court reasoned that the bank was not entirely innocent because of its failure to check the serial numbers on the pink slip against those on the vehicle to prove that the dealer had that car in his possession.

If the conditional vendor is also a trustee by virtue of a trust receipt transaction, the problems of the vendor's assignee become more complicated. These problems will be covered in the section on trust receipts.

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32 Cf. Dennis v. Bank of America Assn., 34 Cal. App.2d 618, 94 P.2d 51 (1939) wherein a cash purchase was made and the customer was protected in spite of her failure to obtain the certificates because proper elements existed for an estoppel as to the dealer.

33 Evidence of this custom was admitted in the Dennis case, supra note 32, CAL. VEH. CODE §§ 186(2), 178(2), enacted after the Dennis case sanctioned this custom.

34 34 Cal. App.2d 618, 94 P.2d 51 (1939).

35 CAL. VEH. CODE § 186(2) now recognizes this procedure.

36 CAL. CIV. CODE § 3543.
Status of Chattel Mortgagee

A novel aspect of automobile registration statutes is the provision for recordation of vehicle chattel mortgages upon the pink slip. This method of registration is salutary in a variety of ways if there is proper compliance, but as is usual with all recording procedures, if the requirements are not observed myriad complexities arise.

With respect to chattel mortgages on articles other than automobiles, California Civil Code Section 2957 prescribes, inter alia, recordation in the county of creation and in counties to which the chattel may be moved. Since the automobile is intrinsically transient, this would impose a substantial burden upon a diligent mortgagee and one equally onerous upon a diligent purchaser or encumbrancer who, in ascertaining the condition of title would have to search practically every county. Vehicle Code Sections 195-198 avoid this by providing a simple system of affording notice by recordation. The mortgagee has himself designated on the pink slip as the legal owner, thereby giving constructive notice of his interest to all subsequent purchasers, encumbrancers, and creditors. Section 198 of the Vehicle Code makes this the exclusive method of giving constructive notice of a mortgage lien.

In Chelhar v. Acme Garage37 an execution creditor of the mortgagor was preferred over a mortgagee who had failed to disclose his lien on the certificate of title but who had repossessed the car before execution. The court reached its result by reliance on the registration requirements of the Motor Vehicle Code in addition to principles established for noncompliance with the general recording provisions of the Code which at that time had to be observed and actually had been observed in the case. The court referred to Section 2973 of the Civil Code and pointed out that according to this section an unrecorded mortgage was valid between the parties and as to creditors who had parted with value after actual notice thereof. Controlling case law had settled that a creditor was not affected by Section 2973 if his debt existed before the mortgage was executed.38 Although the trial court's record did not show whether Chelhar became a creditor before or after the mortgage, the court considered this fact to be immaterial since there was no evidence that he had actual knowledge of the mortgage when extending credit. The repossession was held ineffective to protect the mortgagee's lien because California does not follow the so-called "squeeze-in" rule which protects a creditor only if his lien is obtained while the mortgage is not on record. A creditor who parts with value without notice prior to the unduly delayed recordation may attack his debtor's mortgage upon acquiring a lien even though this lien is not obtained until after recordation,39 or, as in this case, after repossession.40 If the mortgage had been recorded in

38 Old Settlers Investment Co. v. White, 158 Cal. 228, 110 Pac. 922 (1910).
40 Nonpossessory chattel liens were deemed fraudulent under early common law, but recording as a substitute for possession made them possible. Obviously then, repossession by the mortgagee is equivalent to but no better than recordation.
conformity with Section 195 of the Vehicle Code, the creditor would have had the requisite constructive notice.

Since delay in recordation presents questions of priority, many of the cases have arisen in bankruptcy proceedings and are consequently decided by federal courts. Because of a difference of wording between Section 195 of the Vehicle Code and Section 2957 of the Civil Code, a federal district court in In re Wiegand, decided that the mortgagee took precedence over the trustee in bankruptcy. The recordation, although delayed, was, nevertheless, completed before the petition in bankruptcy was filed and therefore before the lien of the trustee under Section 70(c) of the Bankruptcy Act had accrued. The Court of Appeal for the Ninth Circuit in Bank of America Assn. v. Sampsell Assn. criticized the Wiegand opinion for having...

... overlooked the fact that, in California, a creditor may attack his debtor's mortgage even though he is unable to perfect a lien until after the mortgage has been recorded, or the mortgaged property has passed into the hands of the mortgagee.

While, of course, this rule is subject to the qualification that there was undue delay and no actual knowledge it appears that the court in Wiegand did not overlook this general rule. Rather it held that Section 195 of the Vehicle Code because of its special wording stated a "squeeze-in" requirement applicable to vehicles which compelled a creditor to obtain a lien prior to the recordation in order to attack his debtor's mortgage. Any doubts on this point were resolved in 1951 when Section 195 was amended to read: "... Deposit of a certificate within 30 days after the date of any such mortgage shall be deemed a deposit within a reasonable time." The incorporation of the concept of reasonable time in Section 195 necessarily negates the applicability of a "squeeze-in" rule as to vehicle mortgages.

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41 See Citizens Nat. Trust & Savings Bank v. Gardner, 161 F.2d 530 (9th Cir. 1947); Budget Finance Plan v. England, 170 F.2d 59 (9th Cir. 1948); Bowden v. Bank of America, 36 Cal.2d 406, 224 P.2d 713 (1950). These cases are discussed in 39 Calif. L. Rev. 396 at 407, 408 (1951).

42 CAL. VEN. CODE § 195 states that no chattel mortgage is valid (emphasis supplied) "until..." compliance is made. CAL. CIV. CODE § 2987(4) in essence states that a mortgage is "... void unless..." recorded at the time of execution.


44 114 F.2d 211, 213 (9th Cir. 1940).


46 Under Section 70(c) of the Bankruptcy Act, a trustee as of the date of filing of the petition is vested with rights, remedies, and powers of a creditor holding a lien on property of the debtor (whether or not such a creditor exists). It is not likely that the court was unmindful of Section 70(e) which section makes null and void as against the trustee a transfer by the bankrupt that is fraudulent or voidable by a creditor under federal or state law. Unless the "squeeze-in" rule applied, the mortgage in question would be subject to attack by a creditor (and thus by the trustee) even though a lien was not acquired until after recordation.

47 Section 60(a) of the Bankruptcy Act, as amended, 64 Stat. 70 (1950), provides a 21-day grace period. Thus the time of recordation for determining voidable preferences will not be the date of execution if recorded after 21 days. The 30-day provision, of course, is still effective under Section 70(c) and (e) of the Bankruptcy Act to determine whether a transfer is fraudulent or voidable by a creditor.
Status of Foreign Mortgages

The case of *Atha v. Bockius* raised the question of the validity in California of a foreign mortgage, unrecorded within the provisions of Section 195. In that case, a Texas finance company obtained a valid Texas mortgage on a vehicle registered both in California and Louisiana. The loan was made on the strength of the Louisiana registration alone, the existing California registration being unknown at that time to the Texas company. The mortgagor then returned to California, replaced his Louisiana license plates with California ones, and sold the automobile to his sister. The Texas finance company later located the automobile, repossessed it and was sued by the sister for conversion. Under the existing legislation, the purchaser was apparently protected because she had a clear pink slip. On the other hand, the Texas finance company was innocent in giving the loan, and it would seem unfair to allow it to lose its mortgage lien merely because the vehicle was transported across the state line and sold without its consent or knowledge. In deciding which of the two parties to protect, the court recognized that under the comity principle of conflicts law, the Texas mortgage was entitled to recognition within California. The Texas company lost the decision, however, because its laxity in tracing the automobile and its failure to repossess within a reasonable time allowed the purchase by the sister. While the decision is thus based on estoppel due to laches, the comity rule as stated by the court would protect a foreign lienor with a valid foreign security interest who pursues the same diligently. The rule finds numerical support in cases from other jurisdictions and may be as acceptable a result as one favoring the purchaser. Either would sometimes be arbitrary, since both parties would often be equally innocent. No adequate solution to the dilemma appears to be possible under the existing registration machinery in the various states. While the comity rule would be harsh on a California purchaser, a California lender with a valid security interest would be protected in those states that are in accord.

Duplicate White Slip: A New Fraud

Reference has already been made to the duplicate pink slip fraud. *Pike v. Rhinehart* suggests a new fraud possibility with the use of the white

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49 The court cited and relied on Mercantile Acceptance Co. v. Frank, 203 Cal. 483, 265 Pac. 190, 57 A.L.R. 696 (1928), for this proposition. It went on to hold that Vehicle Code Section 195 did not refer to foreign mortgages and was therefore not a legislative rejection of the comity rule announced in the *Frank* case.
51 See Townsend, *The Case of the Mysterious Accessory*, 16 LAW & CONTEMP. PROB. 197, 236 (1951) for tables of legislation in all states.
52 Vehicle Code Section 146.1 provides that the Motor Vehicle Department may require the posting of a bond upon registration of a vehicle registered previously in another state. In cases where the bond is required, innocent purchasers will be protected.
53 See annotation, 13 A.L.R.2d 1312 for a breakdown by states of cases on this subject.
slip. In that case X, the registered owner of a vehicle, traded it to a friend, either giving the friend the registration card or leaving it in the vehicle; there was, however, no endorsement. Y finance company, as chattel mortgagee, held the pink slip on which it was noted as legal owner. After the trade, X proceeded to borrow $5,000 from the Z finance company, giving as part of the collateral another mortgage on the automobile she had traded away. From the proceeds of this loan, the mortgage of Y company was paid and released to X, the mortgagor. The pink slip was then transferred to the Z finance company, which had itself noted as legal owner with the department. As part of the same transfer, X asked for and received a duplicate white slip. On default of X, on the Z mortgage, the automobile was repossessed from the friend, who then sued for conversion. The court held the Z finance company not liable. In answer to an argument of the plaintiff, the court held it not necessary for the trial court to make a specific finding on the issue of whether the Z finance company knew or should have known X did not have possession or that the vehicle had been traded, because the judgment could be sustained under other findings. The court then referred to Section 183 of the Vehicle Code, which provides that the legal owner's title or interest in or to a vehicle may be assigned without the consent of the owner. It is submitted that if the court reached its decision on the basis of Section 183, it failed to appreciate that the Y company did not assign its interest, but, rather, released its interest to the mortgagor. It is one thing for the registered owner to take subject to one security interest and have that interest transferred, or to have a junior lienor subrogated to that interest on redemption from the lien, but an entirely different thing to have the original lien released to the mortgagor and then have the mortgagor create a new lien for a greater amount as was the case here. By not requiring the mortgagee to ascertain that possession was in the mortgagor, the court left the door open to a new kind of fraud, the duplicate white slip fraud. Mere failure to endorse the white slip should not protect the mortgagor or penalize the mortgagor's transferee. Mortgagors who would ordinarily be estopped against their transferee because possession was given for consideration could re-encumber the automobile for much greater amounts than those existing at the time of transfer after merely obtaining a "duplicate" white slip. A solution, none too burdensome, is that of requiring finance companies to establish that the mortgagor has possession. In real property law, possession inconsistent with record title imparts constructive notice.

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54 "A legal owner may assign his title or interest in or to a vehicle registered hereunder to a person other than the owner without the consent of and without affecting the interest of such owner. The department upon receiving a certificate of ownership endorsed by the legal owner and the transferee of legal ownership accompanied by the registration card shall accordingly transfer the legal ownership and shall issue a new certificate of ownership to the new legal owner and a new registration card to the owner."

55 Cal. Veh. Code §§ 175(c) and 182 allow the department to issue duplicate white or pink slips.

and there is no sound policy reason why similar principles should not apply to the possession of automobiles. As in real property law, possession consistent with the record title (pink or white slip) would not require further inquiry by the encumbrancer. Thus, for example, if the fraudulent holder of a duplicate white slip borrowed the automobile for purposes of increasing the size of the loan and the mortgage, the mortgagee would be protected.

**Trust Receipts and the Use of Pink Slips**

Since the rapid growth of the automobile industry, the trust receipt has become almost exclusively the *modus operandi* for automobile financing in other than consumer transactions. In the typical trust receipt transaction, the automobile manufacturer is paid by a bank or finance company (entruster), who "floors" the automobile for the dealer (trustee). Under the Uniform Trust Receipts Law, the transaction must involve the delivery of a writing designating the goods, documents or instruments concerned and reciting the rights of the entruster, but otherwise no particular procedure or formality need be observed. The entruster's rights amount to no more than a security interest in the goods which attach upon receipt of incoming inventory which is financed by the third party. California has amended the Uniform Law to permit as a trust receipt transaction the giving of new value by an entruster in return for a transfer to him of a security interest in vehicles already in the trustee's ownership or possession. Before the amendment to the Uniform Law a trust receipt could be used only upon the original acquisition. Unlike a chattel mortgage, which is void on the stock in trade of a dealer, the trust receipt gives the bank or finance company a valid security interest on inventory. The simple filing procedure is another reason for the popularity of the trust receipt transaction in the financing of motor vehicles. The bank or finance company need only to file annually with the Secretary of State a statement of intent to engage in trust receipt financing with a named trustee, and no further filing is necessary with regard to individual transactions. Trust receipts are then executed as the particular transactions occur. Under the Uniform Law, if a statement of trust receipt financing is filed, only a buyer in the ordinary course of trade who purchases for value and without actual notice can take goods which are subject to the trust receipt free from the security interest of the entruster.

In a bipartite trust receipt transaction involving automobiles to which the dealer has the pink slip, the bank usually requires and takes the pink

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67 Schumacher v. Truman, 134 Cal. 430, 66 Pac. 591 (1901).
70 Cal. Civ. Code §§ 3014 (1) (i) and (ii), and (2).
74 Cal. Civ. Code § 3016.5(2) (a) (1).
slip along with the trust receipt, holding it until a sale is made, at which
time it is endorsed and mailed to the department. If the sale is for cash, the
department is instructed to transfer the pink slip to the buyer. If the sale
is on credit, the bank has itself designated as legal owner with the depart-
ment and retains the pink slip until all payments are made. The buyer
usually makes payments to the bank, which is ordinarily an assignee of the
conditional sale contract. Sometimes, however, payments are made to the
dealer. When payments are completed, the bank endorses the pink slip and
delivers it to the buyer.

If payments are made to the dealer, and the dealer either absconds with
the proceeds or dissipates them, the buyer in course of trade is protected
by the Uniform Trust Receipts Law. But possibilities for fraud on the
entruster arise if the bank does not take an assignment of the sale con-
tract, relying on the dealer to account for the proceeds, (and, of course, the
shifting lien protection of Civil Code Section 3016.6), and the dealer dis-
counts the contract with another bank and dissipates the proceeds. If the
dealer has not exhibited the pink slip to the discounting bank, it is sug-
gested that the entruster’s interest in the vehicle should be protected. That
is to say, lack of the pink slip should be notice to the second bank that the
dealer has no clear title. This result should obtain even if new vehicles are
involved. Although they are not required to be registered, the depart-
ment will issue a certificate of ownership.

If the law were such that entrusters could be assured of protection, they
would undoubtedly insist that the dealer apply for a pink slip in the en-
truster’s name. Many entrusters do this already, despite the fact that, as
demonstrated below, the protection is far from adequate.

Status of Entruster

In regard to compliance with registration requirements and the use of
the pink slip, practice among dealers and entrusters is not consistent and
it is not entirely clear from the case law to what extent the pink slip actually
affects the trust receipt transaction. Several California cases have not only
held the entruster estopped against a buyer in course of trade from the
dealer, but also, on questionable grounds, against the bank that financed
the buyer’s purchase from the trustee by taking an assignment of the con-
ditional sales contract.

In some of the cases protecting the assignee-bank,
the vehicle was registered with the department and pink slips were outstanding. The discounting banks were protected although they had not relied on the pink slips. Those decisions may be correct inasmuch as new automobiles are not customarily registered, but if it became established practice to obtain certificates for all new automobiles it would not be unfair or burdensome to require lender's financing purchases to demand display of a pink slip in all cases in order to be free of an entruster's lien.70

A similar problem is presented when the dealer accepts a used car as part of the purchase price. Under the Uniform Trust Receipts Law, the lien of the entruster attaches to the proceeds from the sale of entrusted goods.71 This places a duty of policing upon the entruster periodically to audit the inventory of the trustee and to seek an accounting.72 As noted, if the proceeds are chattel papers such as conditional sale contracts, the lien of the entruster on the proceeds will not always protect him. In Peoples Finance Co. v. Bowman73 part of the proceeds consisted of a used car taken in part payment by the dealer. The dealer then executed a trust receipt on the used car to a second bank and delivered the pink slip to that bank. The court held that both banks were entrusters who gave new value under Civil Code Section 3013, but placed the loss on the first entruster because "Where one of two innocent persons must suffer by the act of a third, he, by whose negligence it happened, must be the sufferer."74 The court reasoned that the first entruster made the fraud possible by enabling the dealer to obtain possession and the pink slip, thus empowering him to execute the second trust receipt.

In C.I.T. Corp. v. Commercial Bank75 a dealer executed trust receipts to a second entruster on new cars on his floor already covered by prior tri-

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60 Bank of America v. National Funding Corp., 45 Cal. App.2d 320, 114 P.2d 49 (1941). In the very recent case of Security First-Nat. Bank v. Taylor, 123 A.C.A. 414, 266 P.2d 914 (1954), the court held that the bank financing the customer's purchase was itself also a "buyer in the ordinary course of trade" and not a purchaser of the conditional sale contract after the vehicle was sold. This was because the bank conditioned payment of its draft to the customer on the assignment to itself of the conditional sale contract. The court placed emphasis on the prior arrangement between the customer and the bank with regard to the prospective purchase, and intimated that the result would be different if there were not such an arrangement before sale. This decision tends to weaken the trust receipt as a security device. Under the holding of the case, a bank by taking assignment of the conditional sale contract from the trustee simultaneously with the customer's purchase, exempts itself from the notice provision of the Uniform Trust Receipts Law and arrogates to itself the status of a buyer in ordinary course of trade.

If the pink slip could be used as a method of giving notice of the entruster's lien (which shifts to proceeds from the sale of entrusted goods under Civil Code Section 3016.6), the assignee of a conditional sale contract could demand its display for protection and the entruster could protect his interest by retaining it.

70 There is no supreme court decision under the Uniform Law dealing with an assignee of a conditional sale contract involving goods subject to a trust receipt and, thus, of course, no decision by that court under the Uniform Law holding that filing under Civil Code Section 3016.9 is not constructive notice of the entruster's lien which shifts to the proceeds from a sale of goods subject to a trust receipt under Civil Code Section 3016.6.

71 CAL. CIV. CODE § 3016.6.
72 CAL. CIV. CODE § 3016.6(b) (c).
74 Id. at 735, 137 P.2d at 732 (1943).
75 64 Cal. App.2d 722, 149 P2d 439 (1944).
partite trust receipts. The court held the second trust receipts to be ineffective. In reaching this result the court stressed the fact that the title to the cars went directly to and remained in the entruster and that therefore the trustee had only a limited right to possession, enabling him to create a paramount encumbrance only by reasons justifying an estoppel. Such reasons the court held to be absent because of the failure of the second entruster to investigate the trustee's ownership and possession at the time of the extension of credit and because of the notice ensuing from the proper filing of the financing statement by the first entruster. Although at first blush C.I.T. and Bowman may appear to be contradictory, they are reconcilable. In Bowman, title to the used car went directly to the dealer, enabling him to create a valid security interest with a second entruster. The first entruster's security interest lost precedence because he enabled the dealer to execute the valid second trust receipt. The significant difference, however, between the transactions in the two cases is that in Bowman the used car in question constituted proceeds from the sale of entrusted goods, whereas in C.I.T. the cars in question were the original entrusted goods. Bowman, thus, appears to be a holding that filing of a statement of trust receipt financing pursuant to Civil Code Section 3016.9 is not constructive notice of the entruster's lien which shifts to proceeds from the sale of entrusted goods by virtue of Civil Code Section 3016.6. To this extent, the trust receipt is weakened as a security device.

C.I.T. illustrates that the spectre of "title theory" still spooks around in the law of trust receipts, and that the enactment of the Uniform Law in California did not completely displace "title theory" as against "lien theory" from the cases. While the C.I.T. case rests on alternate grounds, it could possibly have been decided on the sole basis of notice from the filing of a trust receipt financing statement. However, the opinion did not specify which entruster filed first. If, as suggested, certificates for new automobiles be obtained, the second finance company would have available a simple system of notice. Instead of checking with the Secretary of State, involving possibly a delay of days, the second finance company could require a pink slip. If it received the pink slip, it would be protected as in Bowman, and the first entruster would suffer the loss for allowing the pink slip to be used by the dealer. If the dealer could not offer a pink slip, the second finance company should be on notice of a prior interest in another.

In National Funding Corp. v. Stump, a dealer's agent sold a new car already covered by a trust receipt to himself, financing the purchase by giving a chattel mortgage. When the car was registered, the mortgagee was noted as legal owner, and the agent was noted as registered owner on both the white and pink slips. After the agent defaulted on the mortgage payments and absconded with the proceeds of the loan, the mortgagee claimed the automobile subject to the mortgage. The court held there was no reason

76 The proposed Uniform Commercial Code positively asserts that title to collateral is immaterial. Section 9-202 Uniform Commercial Code.
why the entruster should not be protected by the Uniform Trust Receipts Law since he had complied with its provisions, and, additionally, that because of very suspicious circumstances which should have put the mortgagee on notice, the possession of the agent would not estop the entruster who had floor the automobile for the dealer to assert his superior right under the trust receipt transaction.

The present California rule, which apparently protects bona fide assignees of conditional sales contracts (which are "proceeds") as against the entrusters, should obviously protect assignees who rely on pink slips left in dealers hands by entrusters. This is a sound result, but needs one further qualification to cover all situations. Before the transaction is completed, the assignee should ascertain that the dealer actually has possession of the automobile about to be sold. This would then protect the assignee against a purchaser's interest if the contract he was discounting were faked as in the Dennis case. Entrusters in bipartite trust receipt transactions should also establish that possession of the vehicle is in the trustee, because he may have sold the vehicle to a purchaser in due course of trade and may only be holding the pink slip for purposes of transferring it to the department for the purchaser as in Dennis.

A rule requiring entrusters, mortgagees, and assignees of conditional sale contracts to rely on possession of the vehicle and the pink slip would render the law relating to security transactions more symmetrical. It would not violate the premise that the certificate of ownership is not the sole muniment of title and would be consistent with the suggestion made earlier that mortgagees require their mortgagors to have possession of the vehicle. If the suggestion is not followed, the state of the California law will be that the certificate in some cases will be the sole muniment of title and in others it will not. If finance companies wish to trust dealers, and do not care to take the recommended steps, they should realize that they do so at their peril.

Conclusion

It is unfortunate that the Legislature has specifically made the pink slip constructive notice to the world only of a mortgagee's interest. However, if it became the custom of the finance business to require display of a pink slip, the courts could recognize such custom, and make lack of possession of the pink slip constructive notice of other interests in the vehicle. To be consistent with the doctrine that the pink slip is not the sole muniment of title, courts should also require those who claim an interest in a motor vehicle to rely on possession of the vehicle as well as of the pink slip. If secured or general creditors do not desire to go to the trouble of checking possession of the vehicle and prefer to trust the party with whom they are

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78 There is no supreme court decision under the Uniform Law. See note 70 supra.
dealing, they should be aware that they act at their peril in case of fraud. These suggestions would not be a discriminatory burden, because the banks that are at times mortgagees or assignees of conditional sale contracts, are at other times, entrusters. Therefore, the suggestions would be for the protection of the business as a whole, giving certainty to the law and providing rules of guidance for the conduct of parties to automobile transactions.

It is believed that while the registration machinery has in the past created recondite problems in the law, this same machinery, and particularly the pink slip, can be used to solve the very problems engendered.

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