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Pledges in West Virginia

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PLEDGES IN WEST VIRGINIA*

The contract of pledge or pawn forms one of the most important sub-divisions of the general law applicable to bailments. At an early day the transaction was not known by the term "pledge", but was rather confined to that of pawning personal effects and did not embrace the larger phases of modern business. To-day, the pawnbroker's activity is a very small part of the business embraced under the topic of pledges. As the business world has advanced, larger demands have been made and met along the line of loans and securities; and from the once small and frequently discredited business of pawns, a new and important law of security transactions has developed. Accordingly, one now finds not only the pawnbroker, but loan and security companies, banks and trust companies, who hold as pledgee the chattels of corporations as well as of individuals, so that the relation of pledgor and pledgee has become an extremely important factor in present day commercial life.

A recent West Virginia case, Highland, Executor v. Davis, has raised anew many of the most interesting phases of the law of pledges. P's testator hypothecated stocks of Y company, along with his note, with the A bank to secure payment of a loan, the note providing that A might sell the stocks on maturity of the note, without demand or notice, at public or private sale. Subsequently, the executor (P) executed a renewal note on similar terms with the same stocks as security, and providing in addition, that the pledgee might become the purchaser of the same. A repledged the notes with the Reconstruction Finance Corporation along with the stocks, (the original note not having been surrendered on execution of the renewal note). D, director in Y company, bought the renewal note, which had then matured, along with the collateral from the Reconstruction Finance Corporation, and at private sale, sold the latter, no notice having been given or demand made upon P. P filed a bill to redeem the stocks alleging that there had been fraud in the sale. The trial chancellor found

* The purpose of this note is to summarize the cases in Virginia until the formation of the state of West Virginia in 1863, and the subsequent West Virginia cases, with reference to the fundamental principles of the law of pledges. The study is primarily for a review of the law in this state and the Virginia cases are included because they are binding in this jurisdiction. More recent Virginia cases are included as being persuasive authority.

1 W. Va., decided December 7, 1937, not reported, petition for rehearing pending.
STUDENT NOTES

fraud and granted to P the right to redeem. D appealed. The court reversed judgment, holding that such a pledge agreement providing for sale, public or private, without notice with the right of the pledgee to purchase, was a valid waiver of the pledgor's rights and that no fraud on the part of D was shown; further, that a pledgee in making a sale of the pledged property must act in good faith with reasonable diligence to secure a fair price for the property and protect the pledgor's interests; the pledgee acting as trustee or agent for the pledgor. The case was remanded for the purpose of ascertaining whether or not the sale price was adequate.

There are four fundamental points involved in the law of pledges. They are: (1) Definitions and General Considerations, (2) Who may Pledge the Subject Matter, (3) Delivery and Possession of the Security, and (4) the Rights and Obligations of the Parties.

1. Definitions and General Considerations. The simplest definition of a pledge or pawn is that it is a deposit of property with another as security for the payment of a debt. Yet, it is important to note that the pledge may be broader in scope than this, i.e., it may be a deposit of goods to secure any obligation. Thus, in Surber v. McClintic, P deposited goods with D, not to secure the payment of an existing debt, but to induce D to enter on his (P's) bond as surety, and to indemnify D in case of any liability on his part. Generally such a pledge, whether for a debt or some other purpose, in the absence of an agreement or implication to the contrary is not subject to any other lien or debt.

Moreover, it is necessary to note the basic distinctions between a pledge or pawn, a conditional sale and a mortgage. In the case of a mortgage, the legal title to the res passes to the mortgagee, subject to be revested in the mortgagor upon the performance of an express condition subsequent, whereas in the case of a pledge, no title passes but merely possession. An exception to this rule is found in the pledge of a bill of lading, where the title to the goods represented passes to the transferee, though the transaction

\[a\] Jones, COLLATERAL SECURITIES AND PLEDGES (3d ed. 1912) § 1; Bank v. Harkness, 42 W. Va. 156, 24 S. E. 548 (1896); In re Rogers, 20 F. Supp. 120 (1937).
\[b\] 10 W. Va. 236 (1877).
is for security purposes only. In a conditional sale, the distinguishing characteristic is a stipulated price for the subject matter, the beneficial interest in the chattel going over to the purchaser.

In the case of Downey v. Insurance Company, there was an attempt to pledge corporate bonds, but the pledge transaction had not been entirely completed, and the court held, that though P had intended his action to result in a pledge, the mere intent to pledge goods in the future was not sufficient to create the relation and that the transaction had to be entirely consummated. It is a general rule that all classes of goods and chattels may be pledged, which includes not only tangible and future goods, but also debts, choses in action and negotiable instruments. There may even be a pledge of future goods, such as growing crops, creating an equitable right in the res. However, it is fundamental that there must be such a delivery as the nature of the goods permits.

The aid which the pledge transaction gives to the business and economic world arises chiefly from the fact that the pledge agreement is a form of security for the creditor and a transfer of the possession of the property which need not be recorded. The surrender by the pledgee of the collateral security is in and of itself a sufficient consideration to support a contractual obligation. A corporation needing money may pledge its unissued stocks and bonds with another for the loan of money, such pledge protecting the lender yet insuring the corporation that the rights of the pledgee in the securities extend only to the amount of the debt.

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6 Roberts v. Cocke, 1 Rand. 121 (Va. 1832). See also Leavell v. Robertson, 2 Leigh 161 (Va. 1830) where A deposited stock with B, his surety, with the stipulation that B was to have the stock if A did not pay the note at maturity. Held, that such an agreement created a conditional sale.
7 77 W. Va. 386, 87 S. E. 467 (1915).
8 Williams v. Price, 5 Manuf. 507 (Va. 1817); Woodson v. Woodson, Wythe 129 (Va. 1791); Raynolds v. Carter, 12 Leigh 166 (Va. 1841); Davis v. Miller, 14 Gratt. 1 (Va. 1857); Donnally v. Hearndon, 41 W. Va. 519, 23 S. E. 646 (1895).
9 Holroyd v. Marshall, 10 H. L. Cas. 191 (1862). See also W. Va. Rev. Code (Michie, 1837) c. 38, art. 11, § 18, giving a lien on future crops where advancements are made on same.
11 Bank v. Harkness, 42 W. Va. 156, 24 S. E. 548 (1896). But see W. Va. Rev. Code (Michie, 1837) c. 40, art. 1, § 7, requiring recordation of pretended loan to protect the lender where the pretended borrower has possession for more than five years or the transaction will be void as to borrower's creditors.
13 Kelley v. Wellsburg etc. Co., 74 W. Va. 130, 81 S. E. 782 (1914).
2. *Who May Pledge.* The owner of goods or one having authority may pledge, but the pledgee of goods from one without authority to pledge or sell the property acquires no lien thereon as against the true owner. Mere possession of a chattel without more, will not enable the possessor to give good title or make a valid pledge. The true owner, however, may subsequently validate the pledge, as where the owner agrees to allow the property to remain in pledge to secure the debt and the pledgee agrees to forbear collection (consideration for such agreement being the pledgee’s forbearance).\(^{14}\)

A mere bailee to whom goods are entrusted, as in the case of a factor holding goods on consignment,\(^{15}\) may not make a valid pledge of such goods for himself,\(^{16}\) nor may an executor pledge the assets of the estate for his own obligations.\(^{17}\) If the one holding goods pledges with the intent to convert the proceeds to his own use, both he and the pledgee are liable in trover whether the pledgee knew of the real state of the title or not.\(^{18}\) Our code expressly exempts the pledgee of a chose in action from any liability on the question of his warranty of the genuineness of such pledged chose,\(^{19}\) when it is redelivered and payment is received in good faith.

3. *Delivery and Possession.* In order that a pledge of personal property may be effectual it is necessary that possession of the property be given to the pledgee. Delivery, however, may be symbolical and the possession according to the nature of the thing, as where there is a delivery of a document of title which serves to put the pledgee in possession and is equivalent to an actual delivery of the goods.\(^{20}\) As a general rule, there must be complete possession in the pledgee,\(^{21}\) but this requirement is satisfied if the

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\(^{15}\) Dodson v. Simpson, 2 Rand. 294 (Va. 1824); Skinner v. Dodge, 4 Hen. & Munn. 432 (Va. 1809).


\(^{17}\) Dodson v. Simpson, 2 Rand. 294 (Va. 1824).


\(^{19}\) W. Va. Rev. Code (Michie, 1937) c. 31, art. 1, § 52.


subject of the pledge is held by a third party for the benefit of the pledgee, when such person is considered as the pledgee’s agent.\textsuperscript{22}

4. **Rights, Duties, and Liabilities of the Parties.** The pledgee of collateral security or other pledge is entitled to hold the same as against the pledgor, notwithstanding that the statute of limitations might be successfully pleaded against the debt for the security of which the pledge was made,\textsuperscript{23} or that the pledgor has subsequently become bankrupt.\textsuperscript{24} Where the property is pledged generally for the debt, if the pledge be lost or destroyed without fault of the pledgee, he may still recover the debt from the pledgor; otherwise, if there be a special contract that the pledgee shall take the pledge as the only security for the debt.\textsuperscript{25} At common law, the pledgee was not liable for the acts of his assignee, but by statutory provision\textsuperscript{26} it is now law that the pledgee who repledges or assigns shall be liable to the owner of the property for the safe keeping and safe return of such property, and for the conduct of his assignee respecting the *res*.

In the old Virginia case of *Hyde v. Nick*,\textsuperscript{27} there was a delivery of a bond to a creditor, (the value of the bond being far in excess of the amount of the obligation), the agreement providing for return of the bond to the transferor upon payment within a certain time. There was a failure to pay within the stipulated time and upon filing a bill in equity to get the bond back the question arose whether the transaction was a conditional sale or a pledge. The rule was laid down that where the consideration is grossly inadequate, the transferor may redeem by a bill in equity, thus indicating the policy of the law to construe such a transaction as a pledge whenever possible. In a controversy where the pledgee is not in possession, but the *res* is in the hands of some third person or junior claimant, equity has jurisdiction to settle the conflicting rights of the pledgees.\textsuperscript{28}

\textsuperscript{22} *Bank v. Harkness*, 42 W. Va. 156, 24 S. E. 548 (1896); \textit{In re Rogers}, 20 F. Supp. 120 (1937).
\textsuperscript{23} *Roots v. Mason City Salt Co.*, 27 W. Va. 483 (1886).
\textsuperscript{24} \textit{In re Rogers}, 20 F. Supp. 120 (1937).
\textsuperscript{25} *Raymonds v. Carter*, 13 Leigh 166 (Va. 1841).
\textsuperscript{26} *W. Va. REV. CODE* (Michie 1937) c. 38, art. 11, § 12. See also *Bank v. County Court*, 94 W. Va. 733, 120 S. E. 878 (1923).
\textsuperscript{27} 5 Leigh 336 (Va. 1834).
\textsuperscript{28} *Realty Inv. Co. v. Lewis, Hubbard & Co.*, 86 W. Va. 10, 102 S. E. 702 (1920).
The pledgee as a general rule, is regarded as a *bona fide* purchaser and is entitled to the same protection. A pledged chattel in the hands of the pledgee is not subject to attachment for the debts of the pledgor. The pledgee of a negotiable note is considered as a holder in due course of such instrument and is not, if it is assigned before maturity, subject to any of the defenses of the original parties, but where such equities exist between the original parties, the pledgee may recover on the security only the amount of the secured debt. By the cases, a valid pre-existing debt is *prima facie* consideration for such transfer of a negotiable instrument, but it is probable that by statutory provision such pre-existing debt is *per se* consideration for the transfer.

The pledgee must use ordinary care to preserve the subject of the pledge, and in case of loss due to theft, the pledgee is bound to exercise ordinary diligence in taking proper measures for a recovery of the subject. In an early Virginia case, where A deposited a slave with B to secure payment of a debt, it was held that even in the absence of such agreement, B should account for the profits of the slave after deduction of interest. This seems to be the rule in most American states, where there is a pledge of an article yielding a profit. However, the pledgor of corporate stock may nevertheless vote it, unless the pledge agreement provides the contrary.

The pledge of property to secure a debt is not, in the absence of an express agreement, to be considered as a general security for all the debts of the pledgor, such rule having application in

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24 W. VA. REV. CODE (Michie, 1937) c. 46, art. 2, § 2.


26 Bank v. County Court, 94 W. Va. 733, 120 S. E. 878 (1923). See also W. VA. REV. CODE (Michie, 1937) c. 33, art. 11, § 12.


28 W. VA. REV. CODE (Michie, 1937) c. 31, art. 1, § 38.
the case of Ferrimer v. Lewis, Hubbard & Co., where collateral was deposited to secure the seller for “certain indebtedness, being an account for merchandise” purchased. It was there held, that the pledge applied only to an existing indebtedness, and not to a running account, and that the words “to be” should not be read into the agreement before the word “purchased”.

Needless to say, the pledgor may sue the pledgee upon a tender of payment and a demand for delivery, where there is a refusal to so deliver the res. A curious result was reached in a 1798 Virginia case, where it was held that if goods were pawned without a day of redemption being set, the pawnor might redeem at any time during his life, but that his executors could not, the right being a personal one. Such a rule is obviously no longer the law. Indeed, the right of an executor to redeem is assumed without discussion in the Highland case.

There have been two West Virginia cases treating the subject of unauthorized handling of the pledged res by the bailee. The result of one case, Schwartz v. Clark, is that where there is a slight deviation from the authorized mode of dealing with the pledged res, and the pledgor has ratified such action, he is thereafter bound by it and has no rights as against the pledgee for the deviation. Recovery was allowed the pledgor, of the stocks pledged, in Kay v. Piney Coal Co., where the pledgee wrongfully repledged them and then purchased same at a sale by the second pledgee, the fraud and bad faith of the original pledgee being the basis of such recovery.

A large body of the law of pledges, as it exists now, concerns the remedies and duties of the pledgee in the protection of his rights and of the pledgor’s rights. As against third parties claiming a right to the subject of the pledge, such parties being creditors of the pledgor, the pledgee may by a bill in equity, restrain interference with the property by the third parties, the pledgee’s lien having priority. Where a non-negotiable note or bond is given by a debtor to his creditor for an existing debt, it is prima facie collateral security and does not suspend the right of action on the

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38 114 W. Va. 629, 173 S. E. 264 (1934).
40 Chapman v. Turner, 1 Call 280, 1 Am. Dec. 514 (Va. 1798).
41 86 W. Va. 244, 103 S. E. 47 (1920).
original debt and therefore does not discharge the sureties, but if the creditor takes from his debtor negotiable notes to the amount of the debt, the law in the absence of an express agreement to the contrary, presumes an agreement to suspend the right to sue on the bond until the maturity of the notes, thus releasing the sureties.

Where a chose in action is transferred to a creditor as collateral security, it is the right of the creditor to sue upon the chose in action at law, using the name of the legal owner. If there is a pledge of commercial paper where the pledgee is authorized to sell the same on maturity of the principal debt, the pledgee is not limited to his remedy by way of sale, but may sue upon the pledged chose at maturity. In case the pledgor gives the note of a third party along with his own note to secure payment of the debt, his note is no bar to recovery on the collateral, and the pledgee need not surrender or account for the note of the pledgor in his attempt to collect on the collateral.

It is the duty of the creditor to use proper care and diligence in the management and collection of the collateral, and if by negligence, wrongful act or omission on his part, loss is sustained, such loss must be borne by him. Sureties of the pledgor will be released to the extent of the damage sustained by the negligence of the creditor to the same extent as though by a positive act of such creditor. There is no liability, however, for delay in collection unless loss to the pledgor is occasioned, and if the pledgor fails to give the pledgee the help necessary for his collection, the pledgee will not be liable for damages due to the delay.

The assignment of a chose in action as collateral security for a debt, will enable the assignee to recover from the debtor the whole

44 Sayre v. King, 17 W. Va. 562 (1880); Hoge v. Vintroux, 21 W. Va. 1 (1882); Peay v. Morrison's Ex'r, 10 Gratt. 149 (Va. 1853).
52 Gibson v. Aglionby, 87 W. Va. 86, 104 S. E. 612 (1920).
liability, the assignee holding the excess in trust for the assignor,\textsuperscript{53} subject to the exception discussed above where equities exist between the maker and the payee assignor. It was held in an early West Virginia decision,\textsuperscript{54} that in the absence of an express agreement\textsuperscript{55} providing for a sale of commercial paper pledged, the pledgee could not sell the same nor could he resort to a court of equity. Such is hardly the law to-day. In any event, the 1931 code,\textsuperscript{56} by providing for a sale of the pledged subject upon reasonable notice and demand, no doubt covers this situation.\textsuperscript{57} Where there is a pledge of perishable goods, the lienor or pledgee may sell such goods after reasonable notice and demand on the pledgor, depending upon the circumstances and the nature of the goods pledged.\textsuperscript{58}

West Virginia has gone far in enforcing drastic pledge agreements as indicated by the \textit{Neuhardt} cases.\textsuperscript{59} Although such agreements are said by a noted commentator to "fall into the prohibited class of agreements for a forfeiture," indicating further, that this class of agreements are or should be void as against public policy,\textsuperscript{60} recent cases, both in West Virginia and other jurisdictions seem to indicate that the parties under a pledge agreement may waive any rights except the right against an express forfeiture.\textsuperscript{61}

A study of this nature necessarily develops small inconsistencies in the law; but careful analysis discloses that West Virginia cases have been kept from obvious conflict by various statutory provisions and by careful regard for previous decisions. Perhaps

\textsuperscript{53} Bentley v. Ins. Co., 40 W. Va. 729, 23 S. E. 584 (1895). See also Shepherd v. Anderson, 2 Pat. & H. 203 (Va. 1856) holding that the pledgee may recover only the amount of his debt where the pledgor could not recover against the maker of the note.

\textsuperscript{54} Miller v. Bank, 85 W. Va. 82, 100 S. E. 864 (1919) where a sale was authorized by the pledge agreement.

\textsuperscript{55} W. Va. Rev. Code (Michie, 1937) c. 38, art. 11, § 14.

\textsuperscript{56} See also Crawford v. Leferve, 78 W. Va. 73, 88 S. E. 1087 (1916).

\textsuperscript{57} W. Va. Rev. Code (Michie, 1937) c. 38, art. 11, § 15 providing for the sale of perishable goods upon reasonable notice and demand. See also Williams v. Price, 5 Munf. 507 (Va. 1817).

\textsuperscript{58} Berry v. Neuhardt, 117 W. Va. 67, 133 S. E. 856 (1936); Bank of New Martinsville v. Neuhardt, 117 W. Va. 70, 133 S. E. 859 (1936); Fisher v. Neuhardt, 117 W. Va. 80, 133 S. E. 861 (1936), all holding that a pledge agreement providing for a sale of the res without notice or demand was valid.

\textsuperscript{59} Seasongood, Drastic Pledge Agreements (1916) 29 Harv. L. Rev. 277.

Bank v. Harkness\textsuperscript{62} contains the most comprehensive treatment of the subject to date, having often been cited by text-writers. Other West Virginia case-law is in accord with the weight of American authority and is by no means an unimportant part of the common law discussion of the subject of pledges.

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\textsuperscript{62} 42 W. Va. 156, 24 S. E. 548 (1896).