

Permanent Editorial Board for the Uniform Commercial Code

PEB COMMENTARY NO. ____

Consignments

Draft for Public Comment

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PEB COMMENTARY NO. []
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INTRODUCTION

Before the 1999 revision of Article 9 and its attendant revision of § 2-326, many believed that “[t]he Uniform Commercial Code’s provisions regarding consignments [were] not models of draftsmanship.”¹ The 1999 revision of Article 9 clarified these provisions, in most cases without changing the rights of the creditors of the consignee.² However, some reported cases and articles suggest that, despite this attempt at clarification, the law of consignments remains puzzling to some of the lawyers and judges who have grappled with it. In an effort to improve the understanding of these rules, this Commentary reiterates the proper legal treatment of consignments and explains where some commentators and courts have erred.

The legal rules governing consignments have a significant effect on the rights of the consignor and the rights of the other creditors of the consignee. A creditor generally has recourse only to the property rights that its debtor has. As explained below in part (1) of the Discussion, a consignee is a bailee. Under general legal principles, a consignee, like other bailees, would have only a special interest (or special property) in the consigned goods limited to the purposes of the bailment (consignment). Ownership of the bailed goods would be retained by the bailor (consignor) and could not be subjected to the claims of the bailee’s (consignee’s) creditors.³ Article 9 dramatically changes this result with respect to the consignments that it governs: Article 9 treats the consignor’s ownership of the goods as a “security interest”⁴ and contemplates that a creditor of a consignee will be able to reach the consignor’s rights in consigned goods if the consignor’s security interest is unperfected.⁵ In that case a judicial lien that the creditor acquires on the consigned goods would be senior to the consignor’s security interest.⁶ To allow for this result, § 9-319(a) provides that “for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, . . . the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to convey.”⁷ The consignee’s creditors benefit from these deemed rights “while the goods are in the possession of the consignee.”⁸

¹ In re State Street Auto Sales, Inc., 81 B.R. 215, 216 (Bankr. D. Mass. 1988).

² U.C.C. § 9-319 cmt. 2.

³ This Commentary assumes that the consignor was the owner of the goods when they were delivered to the consignee, as is typically the case.

⁴ See U.C.C. § 9-102(35) (defining “security interest” to include “any interest of a consignor . . . in a transaction that is subject to Article 9”).

⁵ Even a consignor that perfects its security interest may need to send a purchase-money notification pursuant to § 9-324(b) in order for its security interest to achieve priority over a conflicting security interest in the consigned goods. See U.C.C. § 9-319 cmt. 2, ex. 3.

⁶ U.C.C. § 9-317(a)(2); see U.C.C. § 9-102(a)(52) (defining “lien creditor” to include a person that has acquired a lien “by attachment, levy, or the like”).

⁷ U.C.C. § 9-319(a). This rule is subject to an exception: Law other than Article 9 determines the rights of creditors of the consignee if, under Article 9, “a perfected security interest held by the consignor would have priority over the rights of the creditor.” U.C.C. § 9-319(b).

⁸ U.C.C. § 9-319(a).

If Article 9 does not govern the consignment, non-UCC law determines the rights of creditors of the consignee.

DISCUSSION

This Commentary focuses on three issues: (1) How to distinguish consignments from other transactions; (2) Whether “generally known by its creditors,” as used in § 9-102(a)(20)(A), refers to the knowledge of creditors generally or to the knowledge of a particular creditor; and (3) The effect of the limitation, “while the goods are in the possession of the consignee,” in § 9-319(a).

(1) Distinguishing among types of transactions

Although the term “consignment” is sometimes used to refer to other transactions, a consignment is properly understood to be a bailment, *i.e.*, a transaction in which one person (the bailor) delivers goods to another (the bailee) for a limited purpose. As in every bailment, the consignor-bailor retains ownership of the delivered goods. The law governing a bailment depends on the limited purpose for which the goods are delivered. A true consignment is a delivery of goods to a bailee for the purpose of sale, but is not a sale to the bailee. The person making delivery is a “consignor,” and the person taking delivery is a “consignee.”

Certain true consignments are governed by Article 9.⁹ They are the “consignments” defined in § 9-102(a)(20), which are sometimes referred to as “Article 9 consignments.”¹⁰ An Article 9 consignment does not secure payment or other performance of an obligation. Nevertheless, for purposes of Article 9, the consignor’s ownership interest in goods subject to an Article 9 consignment is treated as a purchase-money security interest in inventory.¹¹

True consignments (*i.e.*, bailments for the purpose of sale) that fall outside the definition of “consignment” in § 9-102 are not governed by Article 9.¹² In these non-Article 9 consignments, the consignor’s ownership interest in the consigned goods is not an Article 9

⁹ U.C.C. § 9-109(a)(4). Not all Article 9 rules apply to a true consignment governed by Article 9. For example, as a general matter, Part 6 of Article 9 does not apply to true consignments. U.C.C. § 9-601(g).

¹⁰ U.C.C. § 9-102(a)(20) defines “consignment” to mean:

a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:

(A) the merchant:

(i) deals in goods of that kind under a name other than the name of the person making delivery;

(ii) is not an auctioneer; and

(iii) is not generally known by its creditors to be substantially engaged in selling the goods of others;

(B) with respect to each delivery, the aggregate value of the goods is \$1,000 or more at the time of delivery;

(C) the goods are not consumer goods immediately before delivery; and

(D) the transaction does not create a security interest that secures an obligation.

¹¹ U.C.C. § 9-103(d).

¹² Nor are they governed by Article 2’s “sale or return” rules discussed below.

security interest. Rather, these transactions are governed by non-UCC law, which typically is the common law, as modified by any applicable non-UCC statutes.¹³

Consignments, which are bailments for the purpose of sale, are different from other bailments, including bailments for hire (leases), which are governed by Article 2A; bailments for storage, as to which Article 7 or non-UCC law may apply; and bailments for processing, which are governed by non-UCC law.¹⁴

Consignments, in which the consignor retains its ownership interest in the goods after delivery, are different from sales, which are transfers of ownership.¹⁵ In some sales, the parties agree that the seller retains an interest in the sold goods until the buyer pays the price. Regardless of whether the agreement characterizes the interest retained by the seller as a security interest or as title, and regardless of whether the agreement purports to be a consignment, the seller's interest is a security interest that secures an obligation, *i.e.*, the buyer's promise to pay.¹⁶ As such, it is governed by Article 9 in the same manner as any other security interest that secures an obligation. It is not treated as an Article 9 "consignment."¹⁷

Sometimes, when goods are sold and delivered to a buyer primarily for resale, the buyer and seller agree that the buyer may return the goods even though they conform to the contract. A transaction of this kind is a "sale or return."¹⁸ Although both a consignment and a sale or return may allow for the return of delivered goods, the transactions are fundamentally different and are mutually exclusive.¹⁹ A consignment is a bailment, and the consignor remains

¹³ U.C.C. § 9-102 cmt. 14 ("A consignment excluded from the application of this Article by [§ 9-102(a)(20)(B) or (C)] may still be a true consignment; however, it is governed by non-Article 9 law."). Non-Article 9 law may be provided by another statute or by a rule of law. For example, many states have non-UCC statutes governing the relationship between artists and art dealers. *See, e.g.*, N.Y. Arts & Cult. Aff. Law §§ 12.01, 12.03 (McKinney 2011 & Supp. 2015). Some of these statutes govern all consignments within their scope, including those that are governed by Article 9.

¹⁴ For an example of an opinion that fails to recognize that the law does not treat all bailments alike, see *In re Mississippi Valley Livestock*, 745 F.3d 299 (7th Cir. 2014). Cattle were delivered to a cattle merchant that agreed to sell them the owner's behalf. Instead of analyzing the transaction as a consignment, the court erroneously treated the transaction as if it were a simple bailment: "Had Mississippi Valley sent the very same cattle back to J & R (as when a theater-goer retrieves her own car from a parking garage after the show), the case would be easy." *Id.* at 304.

¹⁵ *See* U.C.C. § 2-106(1) ("A 'sale' consists in the passing of title from the seller to the buyer for a price . . .").

¹⁶ U.C.C. § 1-201(b)(37) (defining "security interest"); U.C.C. § 9-109(a)(1). In these transactions, the buyer becomes the owner of the goods, even if the agreement designates the buyer as a "consignee."

¹⁷ "[A] security interest that secures an obligation" is excluded from the definition of consignment. U.C.C. § 9-102(a)(20)(D).

¹⁸ "Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is . . . a 'sale or return' if the goods are delivered primarily for resale." U.C.C. § 2-326(1)(b).

¹⁹ Both courts and commentators have missed this essential point. In one case, a merchant took delivery of goods under a contract that provided that the merchant, "as the exclusive agent for Consignor, will offer [the consigned goods] for sale." *In re Morgansen's Ltd.*, 302 B.R. 784, 790 (Bankr. E.D.N.Y. 2003). The merchant's only written obligation was to pay to the consignor the net proceeds of sale, less a commission. *Id.* at 789. The court, however, mistakenly believed that a person who is considered a consignee is a "buyer" for resale." *Id.* Having found that the consignors failed to prove that the transactions were not excluded from the definition of "consignment" by § 9-102(a)(20)(A)(ii) and (A)(iii) (*i.e.*, that the merchant was not an auctioneer and was not generally known by its creditors to be substantially engaged in selling the goods of others), the court nevertheless found that the

the owner of the consigned goods. A sale or return is, as the name suggests, a sale, pursuant to which the buyer becomes the owner of the goods. Absent an agreement otherwise, the seller does not retain any interest in goods delivered to the buyer.²⁰ The buyer becomes the owner of the goods, even though it has a right to return the goods and to transfer ownership back to the seller.²¹ A sale or return is not a consignment; a consignment is not a sale or return.²²

(2) “Generally known by its creditors”

If the consignee is “generally known by its creditors to be substantially engaged in selling the goods of others,” the transaction is not an Article 9 “consignment.”²³ By its terms, the quoted language refers to the knowledge²⁴ of the consignee’s creditors generally. It makes no reference to the knowledge of a particular competing claimant.

The quoted language means what it says. The definition of “consignment” determines which bailments for sale are governed by Article 9’s perfection and priority rules and which are not. Consignments in which a consignee is “generally known by its creditors” to be substantially engaged in selling the goods of others are excluded from Article 9 and are governed by applicable non-UCC law.²⁵

Some authorities have misconstrued the condition contained in § 9-102(a)(20)(A)(iii) by interpreting “generally known by its creditors” to mean “known by the competing claimant.”²⁶ Under this misinterpretation, a given transaction would be a consignment subject to Article 9’s perfection and priority rules vis-à-vis creditors without actual knowledge that the person in possession is “substantially engaged in selling the goods of others” and would be excluded from

transactions were not “consignments” as defined in Article 9. Rather than applying the common law, the court erroneously turned to § 2-326 and concluded that “the goods consigned to the debtor clearly were delivered on a ‘sale or return’ basis.” *Id.* See also Hilary Jay, *A Picture Imperfect: The Rights of Art Consignor-Collectors When Their Art Dealer Files for Bankruptcy*, 58 Duke L.J. 1859 (2009) (proceeding on the erroneous premise that a consignment can also be a sale or return).

²⁰ See U.C.C. § 2-401(1) (providing that “[a]ny retention of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest.”)

²¹ See U.C.C. § 2-326(1) cmt. 1 (stating that a sale or return “is a present sale of goods which may be undone at the buyer’s option”).

²² Some of the confusion may have arisen from former § 2-326, whose caption included the words “Consignment Sales” and whose subsection (3) deemed certain goods that were delivered for sale (*i.e.*, that were the subject of a consignment) to be held on sale or return. To conform § 2-326 with Revised Article 9, the caption was amended and former subsection (3) was deleted.

²³ U.C.C. § 9-102(a)(20)(A)(iii).

²⁴ “Knowledge” means “actual knowledge.” U.C.C. § 1-202(b).

²⁵ Under non-UCC law, the goods of a consignor typically would not be subject to the claims of the consignee’s creditors. See U.C.C. § 9-109, cmt. 6. This would be the case for a consignment that is excluded from Article 9, whether because the consignee is generally known by its creditors to be substantially engaged in selling the goods of others (§ 9-102(a)(20)(A)(iii)), the aggregate value of the goods is less than \$1000 (§ 9-102(a)(20)(B)), or the goods were consumer goods immediately before delivery (§ 9-102(a)(20)(C)). See *In re Haley & Steele, Inc.*, 20 Mass. L. Rptr. 204, 58 UCC Rep. Serv. 2d 394 (2005) (goods of consignor that were consumer goods before delivery to the consignee were not subject to the claims of the consignee’s creditors). The filing of a financing statement by a consignor whose consignment is excluded from Article 9 would be a meaningless act under Article 9.

²⁶ See, *e.g.*, *Fariba v. Dealer Services Corporation*, 100 Cal. Rptr. 3d 219 (2009) & authorities cited therein.

Article 9 as to creditors with that actual knowledge. This anomalous result would open the door to circular priorities²⁷ without promoting any Article 9 policy.

A proper reading of “generally known by its creditors” does not allow for such a result and is consistent with Article 9’s policies concerning the limited role of knowledge in priority disputes. The priority between competing security interests in goods (including purchase-money security interests) is not affected by what the competing claimants know,²⁸ nor is the priority between a security interest and a judicial lien.²⁹ Knowledge may be relevant to the priority of buyers.³⁰ But inasmuch as consigned goods are held for sale by a merchant that “deals in goods of that kind,”³¹ a buyer of the goods almost invariably will qualify as a buyer in ordinary course of business³² and, as such, will take free of the consignor’s security interest, even if the buyer knows of its existence.³³

(3) “*While the goods are in the possession of the consignee*”

As explained in the Introduction, for purposes of determining the rights of creditors of the consignee, a consignee generally is deemed to have rights and title identical to those that the consignor had or had power to convey, in which case creditors of the consignee have recourse to the consigned goods.³⁴ The general rule applies, and the consignee’s creditors benefit from these deemed rights and title “while the goods are in the possession of the consignee.”³⁵ After the

²⁷ Consider a consignment of goods by Consignor to Consignee that is within the definition of “consignment” in Article 9. In particular, the consignment meets the condition in § 9-102(a)(20)(A)(iii) that Consignee “is not generally known by its creditors to be substantially engaged in selling the goods of others.” Consignor fails to file a financing statement against Consignee covering the goods and so holds an unperfected security interest. While the goods are in Consignee’s possession, Consignee grants a security interest in them to SP-1, who knows that Consignee holds the goods on consignment and perfects a security interest in them by filing. Thereafter, while the goods are still in Consignee’s possession, Consignee grants a security interest in the goods to SP-2, who also perfects a security interest in the goods by filing but lacks knowledge of the consignment. Under Article 9, SP-1’s knowledge of the consignment would be irrelevant. SP-1’s security interest would attach to Consignor’s rights and title to the goods and would be perfected by filing, as would SP-2’s. See § 9-319(a); § 9-310(a). SP-1’s perfected security interest would be senior to SP-2’s under the first-to-file-or-perfect rule of § 9-322(a)(1), and Consignor’s unperfected security interest would be junior to both perfected security interests under § 9-322(a)(2). Now consider what the outcome would be under an erroneous interpretation of § 9-102(a)(20)(A)(iii), *i.e.*, that SP-1’s knowledge of the consignment results in the application of non-UCC law to SP-1’s claim against the goods, even though they are the subject of an Article 9 consignment. Under non-UCC law, the consigned goods typically would not be subject to the claims of Consignee’s creditors. As a consequence of the misinterpretation of § 9-102(a)(20)(A)(iii), no one of the three competing security interests would have priority over both of the other two, and a circular priority would arise. Consignor would have non-UCC priority over SP-1; SP-1, as the first to file or perfect, would have priority over SP-2; and SP-2’s perfected security interest would have priority over Consignor’s unperfected security interest (which, in turn would have priority over SP-1’s security interest, and so on).

²⁸ See U.C.C. § 9-322(a) & cmt. 4; § 9-324.

²⁹ See U.C.C. § 9-317(a), (e).

³⁰ See U.C.C. § 9-317(b), (e).

³¹ U.C.C. § 9-102(a)(20)(A)(i).

³² See U.C.C. § 1-201(a)(9) (defining “buyer in ordinary course of business” to include only buyers that buy from “a person, other than a pawnbroker, in the business of selling goods of that kind”).

³³ U.C.C. § 9-320(a).

³⁴ U.C.C. § 9-319.

³⁵ U.C.C. § 9-319(a). “‘Consignee’ means a merchant to which goods are delivered in a consignment.” U.C.C. § 9-102(a)(19). The termination of a consignment agreement does not *ipso facto* cause a “consignee” to lose its status as such, nor does it insulate the consigned goods from the reach of the consignee’s creditors if the consignor’s interest is

goods have been returned to the consignor, the consignee loses all rights to the goods and so no longer can encumber them by creating a security interest. Nor can the consignee's creditors acquire a judicial lien on the goods after that time.

The result differs when the consignee creates a security interest in consigned goods while they are in the consignee's possession and then returns the unsold goods to the consignor. The fact that the goods no longer are in the possession of the consignee, which is no longer deemed to have the consignor's rights and title, does not strip the consignee's secured party of its security interest. Under § 9-319(a) the consignee had rights in and the power to transfer the consigned goods while the goods were in the possession of the consignee. Once the other requirements of § 9-203(b) were satisfied, the security interest became "enforceable against the debtor [the consignee] and third parties."³⁶ If the debtor-consignee were then to sell the goods to a buyer out of the ordinary course, the security interest of the consignee's secured party ordinarily would continue, even though the debtor-consignee would no longer have any rights in, or title to, the sold goods.³⁷ If the consignee returns collateral (goods) to their owner, *a fortiori* an enforceable security interest in the collateral would continue, unless the consignee's secured party authorized the return free of its security interest.³⁸

AMENDMENTS TO OFFICIAL COMMENTS

With the discussion in this Commentary in mind the Official Comments are amended as follow.

Official Comment 4 to § 2-326 is amended to read:

4. The transactions governed by this section are sales; the persons to whom the goods are delivered are buyers. This section has no application to transactions in which goods are delivered to a person who has neither bought the goods nor contracted to buy them. See PEB Commentary No. [], dated _____ . Transactions in which a non-buyer takes delivery of goods for the purpose of selling them are bailments called consignments. Certain true consignment transactions were dealt with in former Sections 2-326(3) and 9-114. These provisions have been deleted and have been replaced by new provisions in Article 9. See, e.g., Sections 9-109(a)(4); 9-103(d); 9-319.

Official Comment 14 to § 9-102 is amended by adding at the end the following new paragraph:

unperfected. The suggestion to the contrary in *In re Valley Media, Inc.*, 279 B.R. 105 (Bankr. D. Del. 2002), is incorrect.

³⁶ U.C.C. § 9-203(b).

³⁷ See U.C.C. § 9-315(a)(1) (providing that, with some exceptions, a security interest continues in collateral notwithstanding a sale or other disposition thereof). It is incorrect to read § 9-319(a) itself as cutting off the security interest of the consignee's secured party after the security interest has attached, even if the goods are subsequently sold or otherwise disposed of by the consignee. As § 9-315(a)(1) provides, the security interest would be cut off if the secured party authorized the disposition free of the security interest or if the security interest was cut off under § 2-403(2) or another provision of Article 9, such as § 9-320(a).

³⁸ See U.C.C. § 9-315(a)(1). Any suggestion to the contrary, as in *Fariba*, *supra* note 24, is incorrect.

Under clause (iii) of subparagraph (A), a transaction is not an Article 9 “consignment” if the consignee is “generally known by its creditors to be substantially engaged in selling the goods of others.” Clause (iii) does not apply solely because a particular competing claimant knows that the goods are held on consignment. See PEB Commentary No. [], dated _____.

Official Comment 6 to § 9-109 is amended to read:

6. This Article does not apply to a bailment for sale that falls outside of the definition of “consignment.” See PEB Commentary No. [], dated _____.

The first paragraph Official Comment 2 to § 9-319 is amended to read as follows, with the second paragraph added:

2. **Consignments.** This section takes an approach to consignments similar to that taken by Section 9-318 with respect to buyers of accounts and chattel paper. Revised Section 1-201(b)(35) defines “security interest” to include the interest of a consignor of goods under many true consignments. Section 9-319(a) provides that, for purposes of determining the rights of certain third parties, the consignee is deemed to acquire all rights and title that the consignor had, if the consignor’s security interest is unperfected. The consignee acquires these rights even though, as between the parties, it purchases a limited interest in the goods (as would be the case in a true consignment, under which the consignee acquires only the interest of a bailee). As a consequence of this section, creditors of the consignee can acquire judicial liens and security interests in the goods while the goods are in the possession of the consignee.

The termination of a consignment agreement does not *ipso facto* cause the consignee to lose its status as such, nor does it deprive the consignee of the deemed rights and title provided by subsection (a). Return of the goods to the consignor causes the consignee to lose its deemed rights and title, but it does not discharge a security interest or judicial lien that attached while the consignee was in possession. See PEB Commentary No. [], dated _____.

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