Untangling the Web of Consignment Law: The Journey from the Common Law & Article 2 to Revised Article 9

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ARTICLE 2 TO REVISED ARTICLE 9

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ABSTRACT

This Article examines and analyzes the law of consignments from the common law through Revised Article 9 with a goal towards identifying and analyzing the uncertainties and confusion that have persisted throughout the transition from the common law to the UCC. The law of consignments has abounded with uncertainty since its genesis under common law. In an attempt to clarify the persistent confusion and disarray surrounding the law, the UCC enacted section 2-326; but the statute was not a model of clarity, engendering increased uncertainty and confusion. Courts wrestled with how to interpret the provision to be consistent with the intent of the UCC drafters. In 1999, the UCC moved consignments from Article 2 to Article 9 and made substantial revisions to both Articles to provide greater clarity. While Article 9 provides a much more comprehensive legal framework for consignments, in many respects it is a reformulation of former Article 2-326. Thus, many of the uncertainties concomitant with the Article 2 coverage of consignments continue to persist under Article 9. And the revisions to Article 9 have generated new issues on which courts are split, creating even more confusion. In August 2017, the Permanent Editorial Board for the Uniform Commercial Code drafted a Commentary and proposed certain amendments to resolve some of the uncertainties surrounding the Article 9 revisions. The commentary and amendments provide much-needed clarity, but they leave unresolved several

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significant issues in which uncertainty persists and on which courts are split. The goal of this Article is to identify and analyze the various uncertainties that have arisen from the common law through Revised Article 9 and to propose revisions that include removing consignments from the definitional provision of Article 9 to its own separate provision in Article 9 to resolve more extensively the persistent and burgeoning uncertainties identified throughout this Article.
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INTRODUCTION

In 1979, one commentator discussing consignments stated that “[f]ew widely used commercial devices have had so checkered and volatile a legal history as the consignment. And few such devices have been able to survive so long and tortuous a legal history and yet retain so many elements of confusion and disarray.”¹ Almost forty years later, the confusion and disarray surrounding consignments persist. Once governed by common law, later by Article 2 of Uniform Commercial Code (UCC), and, currently, by Revised Article 9 of the UCC, each iteration of consignment law has presented the courts with a myriad of legal challenges all stemming from one central issue: Whether creditors of a consignee can assert claims against consigned goods in the possession of their debtor/consignee?²

Under the common law, consignee’s creditors could not assert claims against consigned goods even though consignors were not required to provide public notice of their consignment transactions.³ This was problematic for creditors of consignees, who often provided funding under the mistaken belief that consignees’ possession of consigned goods signified their ownership of them.⁴ The common law also presented various legal challenges as courts grappled with how to distinguish consignments from other types of commercial transactions that shared similar characteristics.⁵

The decision to remove consignments from common law coverage to Article 2 was motivated by both a desire to provide greater clarity and to remedy the concern that the consignee’s ostensible ownership of consigned goods misled creditors who were unaware of undisclosed consignment arrangements.⁶ Unlike the common law, section 2-326 provided that a consignee’s creditors could assert claims against consigned goods unless the consignor could prove

² See infra Parts II–V.
⁴ See id.
⁵ See infra note 26.
⁶ Hicinbothem, supra note 3, at 62–63.
that one of the exceptions found in section 2-326(3) applied. Each exception was premised on the idea that a consignee's creditors were either generally aware or had notice of the consignment arrangement, thereby eliminating the concern regarding secret liens. However, even after the enactment of UCC section 2-326, the confusion and disarray surrounding consignments persisted. Section 2-326 engendered uncertainty presenting various problems for the courts, which split on how to judiciously interpret the section to achieve the underlying goals of Article 2. In 1980, two prominent commentators stated that, “[t]he Code’s handling of consignments is fraught with uncertainty, and the Code cases on the subject clear up little.”

The decision to move consignments from Article 2 to Article 9 was prompted by a desire to provide greater clarity and to resolve in an efficient and comprehensive manner the persistent and ever burgeoning uncertainties that surrounded Article 2. The move to Article 9 came with substantial revisions to Articles 2 and 9 with an expectation for greater clarity, uniformity, and predictability to the law of consignments. Specifically, the Article 9 revisions treat the law of consignments in a more comprehensive fashion. It has not succeeded, however, in resolving

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8 Id. § 2-326 cmt. 2 (1999).
9 See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, DRAFT FOR PUBLIC COMMENT 1 (August 14, 2017) [hereinafter PEB COMMENTARY DRAFT].
10 Id. The Draft notes that “[b]efore 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.’” Id.
12 See PEB COMMENTARY DRAFT, supra note 9, at 1 (noting that “[t]he 1999 revision of Article 9 clarified these provisions, in most cases without changing the rights of the creditors of the consignee”).
13 See id.
14 Under Article 9, consignments are classified as purchase money security interests; and consignors are required to perfect their interests by filing a financing statement to protect their interest against judicial lien creditors. U.C.C. §§ 9-103(d), 9-310(a) (AM. LAW INST. & UNIF. LAW COMM’N 2017). And to protect their interest against secured creditors, consignors must file a financing
all of the uncertainties that were left unanswered by its predecessor.\textsuperscript{15} And the advent of the 1999 revisions engendered some new issues about which courts and commentators are uncertain.\textsuperscript{16} In August 2017, the Permanent Editorial Board (PEB) for the UCC drafted proposed amendments to Articles 2 and 9’s Official Comments to resolve some of the uncertainties which persist.\textsuperscript{17} The Official Comments provide much-needed clarification but still leave some of the issues presented in recent court opinions unresolved.\textsuperscript{18}

The goal of this Article is to identify the various uncertainties that have arisen and their genesis, analyze the legal effect of those uncertainties, and discuss how those uncertainties can best be resolved to promote the underlying goals of Article 9. This Article also highlights how the draft PEB proposed amendments to Article 2 and 9’s Official Comments seek to resolve some of the uncertainties. As part of the analysis, this Article provides an in-depth look at the jurisprudence that has developed from the common law through the 1999 UCC revisions.

Part I of the Article provides an overview of consignments. Part II of the Article examines the common law treatment of consignments. Part III examines pre-1999 UCC treatment of consignments, identifying and analyzing the areas of uncertainty involving competing claims to consigned goods. Part IV discusses the 1999 UCC consignment law revisions as they pertain to the rights of consignors and consignee creditors and analyzes the uncertainties that have arisen concerning these parties’ rights. Part V discusses judicial treatment of consignments under Revised Article 9 with a goal towards providing resolutions for the uncertainties created by the revision. The Conclusion states that a comprehensive revision to Article 9 consignment law should be considered that includes moving consignment coverage from the definitional provision of Article 9 to its own separate provision to resolve fully the uncertainties identified throughout this Article.

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\textsuperscript{15} See PEB COMMENTARY DRAFT, supra note 9, at 1.
\textsuperscript{16} See infra Part V.
\textsuperscript{17} PEB COMMENTARY DRAFT, supra note 9, at 6–7.
\textsuperscript{18} See infra Part V.
I. OVERVIEW OF CONSIGNMENTS

A. Introduction

A true consignment transaction involves the entrusting or delivery of goods by the owner, the consignor, to another party, the consignee, with the understanding that the consignee will attempt to sell the good on behalf of the consignor. Generally, owners use consignments to avoid the risk associated with finding a market for, and to maintain control over the pricing of, their goods. In a “true consignment,” the consignor maintains control over the pricing of the consigned good and retains title and ownership of the good. The good is delivered to the consignee who is authorized to sell the good based on the consent of the consignor, and the consignor establishes the price at which the consignee must sell the good. Any time prior to sale of the good, the consignor can demand return of it, and when the consignee does sell the good, the consignee is paid a set commission by the consignor, rather than receive a profit. The consignee must return the good if it is not sold, and at no time is the consignee obligated to pay for the good.

The operative word in the term true consignment is the term true because, even though parties may title their agreement a consignment, a court may conclude that the agreement is an entirely different type of commercial transaction such as an outright sale, sale or return, true bailment, or even a security interest securing an obligation. Courts have long-wrestled with how to distinguish true consignments from the other types of commercial transactions that are facially similar to, but substantively different from, consignments. A court’s conclusion that an agreement

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22 Excel Bank, 209 S.W.3d at 808.
23 Id.
24 Id. at 807–08.
25 See id. at 805.
26 See In re Mississippi Valley Livestock, Inc., 745 F.3d 299, 302–04 (7th Cir. 2014); Nektalov, 440 F. Supp. 2d at 299–302 (S.D.N.Y. 2006); Liebzeit v. FVTS Acquisition Co. (In re Wolverine Fire Apparatus Co. of Sherwood Michigan),
titled a *consignment* is in actuality an entirely different type of commercial transaction may be a game changer concerning the respective rights of the parties asserting competing interests in the consigned goods.27

**B. True Consignment**

A true consignment creates a bailment agency relationship with the consignor as the principal and the consignee as the agent.28 In *Liebzeit v. FVTS Acquisition Co.*, the bankruptcy court for the Eastern District of Wisconsin defined a true consignment as:

[A] simple sales agency in which goods are delivered to a dealer for resale purposes, and this device is used as a price-fixing arrangement whereby the consignor may direct that the consignee charge a certain price for the goods. Both parties anticipate that the goods will eventually be transferred to a third party, and the consignor will be paid thereafter, usually with payment reduced by the consignee’s fee.29

Consignments are considered a type of bailment (bailments for the purpose of sale) because they, like bailments, involve the entrusting or delivering of a thing to another person by an owner who retains title and control over the thing the owner delivered.30 But true consignments satisfying the Article 9 statutory definition are governed by the UCC while Article 9 does not apply to true bailments.31 Notwithstanding the difference in legal treatment

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28 Nektalov, 440 F. Supp. 2d at 298.
30 Id.; see Excel Bank, 209 S.W.3d at 804.
31 The Uniform Commercial Code does not apply to transactions that are purely bailments. *In re Wolverine Fire Apparatus Co.*, 465 B.R. at 819.
however, every consignment can be considered a type of bailment, but not every bailment is a consignment. The reason is that, in a true bailment, the goods delivered by the bailor are the same goods returned to the bailor once the purpose for which the bailment was created has been fulfilled. While in a consignment, the consignor delivers the goods to the consignee for resale, and those goods are only returned to the consignor if the consignee is unable to sell them. Even though goods are only returned in a consignment if they are not sold, the United States Supreme Court in as early as 1893 in Sturm v. Booker noted that consignments were still a type of bailment stating that: “[t]he agency to sell and return the proceeds, or the specific goods if not sold, stands upon precisely the same footing [as a bailment], and does not involve a change of title.”

II. COMMON LAW TREATMENT OF CONSIGNMENTS

Under the common law, creditors of a consignee had no claim against consigned goods in the possession of the consignee. Consignments were viewed as true bailments in which the title to the consigned goods remained with the consignor creating an agency relationship between the consignor and the consignee.

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32 Id. at 818.
33 See In re Mississippi Valley Livestock, Inc., 745 F.3d 299, 302–03 (7th Cir. 2014).
34 Ludvigh v. American Woolen Co., 231 U.S. 522, 530 (1913); JP Morgan Chase Bank, N.A., v. AVCO Corp. (In re Citation Corp.), 349 B.R. 290, 296–97 (Bankr. N.D. Ala. 2006) (finding that a bailment, not a consignment agreement, was executed by the parties highlighting that the owner did not authorize the bailee to sell the good it had delivered); United States v. Nektalov, 440 F. Supp. 2d 287, 298 (S.D.N.Y. 2006); In re Morgansen’s Ltd., 302 B.R. 784, 790 (Bankr. E.D.N.Y. 2003); see Fariba v. Dealer Servs. Corp., 100 Cal. Rptr. 3d 219, 225–26 (Cal. Ct. App. 2009).
36 See Sturm, 150 U.S. at 330 (“An essential incident to trust property is that the trustee or bailee can never make use of it for his own benefit. Nor can it be subjected by his creditors to the payment of his debts.”); Ludvigh, 231 U.S. at 528; Gen. Elec. Credit Corp. v. Strickland Div. of Rebel Lumber Co., 437 So. 2d 1240, 1244 (Ala. 1983) (noting that prior to the UCC “[i]f the consignee had an absolute right to return unsold goods without any obligation to pay for them, the arrangement fell outside the requirement for chattel mortgages and liens.”).
37 Ludvigh, 231 U.S. at 528.
The consignment transaction was emphasized as a bailment with a right of return of the good to the consignor. Since title to the consigned goods remained with the consignor, consignee’s creditors had no claims to such goods, thus preventing them from securing an interest or attaching a lien to them. As such, consigned goods were impervious to claims asserted by consignees’ creditors, even though the creditors had provided financing based on their consignee/debtor’s apparent ownership of the goods.

The common law treatment of consignments placed a consignee’s creditor in the unenviable position of having to forfeit its perceived claim to consigned goods after having relied on a consignee’s possession of those goods in providing financing. In many instances, creditors made loans secured by debtors’ inventory under the mistaken belief that a consignee’s possession of the consigned goods signified its ownership of them. The result was particularly troublesome since the law did not require consignors to record or provide any type of notice to prospective creditors of their interests. Effectively, the undisclosed consignment agreements created secret liens on what appeared to the consignee’s creditors as the consignee’s inventory. Consequently, consignee’s creditors bore the risk of loss even though in many instances they were not able to discover the consignment transaction.

III. UCC Article 2 Treatment of Consignment Law

A. Introduction

Former section 2-326 of the UCC was adopted to protect creditors against hidden liens of consignors when consignees had

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38 Id.
40 See id. at 807.
41 Hicinbothem, supra note 3, at 62.
43 Hicinbothem, supra note 3, at 62.
44 Excel Bank, 209 S.W.3d at 807.
45 See id.
ostensible ownership of those goods. Under former section 2-326, goods delivered primarily for resale would be classified as a “sale or return” transaction if the goods were delivered for sale and the person to whom they were delivered maintained “a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery.” While such goods were in the buyer’s possession, they would be subject to the claims of the buyer’s creditors. Section 2-326 deemphasized the consignor’s reservation of the title as the hallmark for protecting consigned goods from the reach of the consignee’s creditors by providing instead that “[t]he provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as ‘on consignment.’” Subjecting the consigned goods to the claims of the consignee’s creditors effectively shifted the risk of loss from consignees’ creditors to the consignor, reversing the common law result that placed the risk of loss with the consignee’s creditors.

Section 2-326(3) did provide, however, that a consignor could avoid claims of consignee’s creditors if the consignor proved: (a) the consignor had complied with an applicable sign law; (b) it was generally known by the consignee’s creditors that the consignee was substantially engaged in selling the goods of others; or (c)

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47 U.C.C. § 2-326(3) (1999) (AM. LAW INST. & UNIF. LAW COMM’N, amended 1999). A merchant was viewed as operating under a name other than the deliverer’s name provided that the consignee did not “so completely identify his business with that of the consignor ‘that potential creditors would necessarily assume that the business was that of the consignor solely.’” In re Wicaco Mach. Corp., 49 B.R. at 343.

48 U.C.C. § 2-326(2) (1999); see Underwriters at Lloyds v. Shimer (In re Ide Jewelry Co., Inc.), 75 B.R. 969, 974 (Bankr. S.D.N.Y. 1987) (noting that the goods must be in the “buyer’s possession at the time the buyer’s creditor assert their claims, in order for those goods to be subject to their claims” under section 2-326).


the consignor had complied with section 9-114. The underlying premise of each exception was that notice had been given to a consignee’s creditors that the consigned goods were not owned by the consignee, thereby eliminating any concern regarding undisclosed consignment arrangements.

Courts interpreted section 2-326(3) as placing the burden of proof on the consignor to establish that it had satisfied one of the exceptions to avoid claims of a consignee’s creditors. In order to avoid consignees’ creditors’ claims, consignors alleged frequently that creditors’ claims were precluded by one of the three exceptions in section 2-326(3) or that Article 2 did not apply to the consignment because it did not qualify as a “sale or return.” Much confusion existed surrounding how to determine whether an exception applied and what rendered a consignment a “sale or return.” It became apparent that Article 2’s coverage of consignments was “fraught with uncertainty,” as the courts grappled specifically with two distinctive issues: (1) Whether certain 2-326(3) exceptions applied and (2) Whether the consignment transaction was a “sale or return,” or a consignment intended as a security interest governed by Article 9, rather than Article 2.

B. Section 2-326(3) Exceptions

1. “Generally Known by Creditors” Exception

The most commonly proffered exception asserted by consignors was section 2-326(3)(b), which provided that a consignor

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51 U.C.C. § 2-326(3) (1999); see GBS Meat Indus. Pty. Ltd., 474 F. Supp. at 1362 (noting the three exceptions of § 2-326(3)); Eurpac Serv. Inc., 37 P.3d at 450 (noting that “[t]his shifting of risks to the consignor is not complete, however, as § 2-326(3) provides three exceptions.”).
54 See, e.g., In re Wicaco Mach. Corp., 49 B.R. at 342–44.
55 Id.
57 See, e.g., In re Wicaco Mach. Corp., 49 B.R. at 342–44.
could avoid a consignee’s creditors’ claims if it could prove that
the creditors of the consignee generally knew that the consignee
was substantially engaged in selling the goods of others.58 How
best to interpret this exception caused a split in the courts, fuel-
ing uncertainty concerning the level of proof necessary to satisfy
section 2-326(3)(b).59 The most contentious issue surrounding
the “generally known” exception was whether a consignor met
its burden of proof by merely establishing that the creditor com-
peting against it had actual knowledge of the consignee’s prac-
tices.60 If the purpose of section 2-326 was to protect creditors
which had been misled by secret liens, did a creditor with actual
knowledge of the consignment have any justifiable legal basis under
section 2-326 to assert its claim against the consigned goods?61

Courts that ruled a consignor met its burden of proof by
establishing that the competing creditor has actual knowledge
justified their rulings by emphasizing the UCC policy underlying
the adoption of section 2-326.62 They stressed that section 2-326
was adopted to protect only those creditors that had provided fund-
ing under a mistaken belief that their debtor owned the consigned
goods in its possession.63 If a creditor knew about the consign-
ment arrangement it had no need of protection.64 In GBS Meat

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1999); see GBS Meat Indus. Pty. Ltd. v. Kress-Dobkin Co., 474 F. Supp. 1357,
1362–63 (W.D. Pa. 1979); Eurpac Serv. Inc. v. Republic Acceptance Corp., 37
v. Olsen, 403 N.W.2d 661, 665 (Minn. Ct. App. 1987); Belmont Int’l, Inc., 831
P.2d at 19.

59 See, e.g., Eurpac Serv. Inc., 37 P.3d at 450–51. But see, e.g., In re Wicaco

37 P.3d at 450–51; First Nat’l Bank of Blooming Prairie, 403 N.W.2d at 665;
Belmont Int’l, Inc., 831 P.2d at 19.

61 Eurpac Serv. Inc., 37 P.3d at 450–51; First Nat’l Bank of Blooming Prairie,
403 N.W.2d at 665; Belmont Int’l, 831 P.2d at 19.

37 P.3d at 450–51; First Nat’l Bank of Blooming Prairie, 403 N.W.2d at 665;
Belmont Int’l, 831 P.2d at 19.


64 GBS Meat Indus. Pty. Ltd., 474 F. Supp. at 1362–63; First Nat’l Bank of
Blooming Prairie, 403 N.W.2d at 665.
Industry Pty. Ltd. v. Kress-Dobkin Co. the federal district court in the Western District of Pennsylvania stated the following:

The clear import of the comments to § 2-326, and the judicial precedents discussed above establish that, where a secured creditor knows that the proceeds [from the sale of consigned goods] rightfully belong to a consignor, the consignor must have priority. Any other construction of § 2-326 would contravene the intent of that section and would sanction intentional conversions of [consigned] goods or proceeds.65

In Belmont International v. American International Shoe Company, the Supreme Court of Oregon criticized those courts that required consignors to prove that most creditors had knowledge of the consignee’s business practice stating that those courts placed too much emphasis on the “s” in “creditors.”66 And in Eurpac v. Republic, the Colorado Court of Appeals stated that it was absurd to interpret section 2-326 as not holding a creditor responsible if it had actual knowledge, since the provision imputes knowledge to unknowing creditors if such knowledge could reasonably have been obtained since it was generally known by a consignee’s creditors.67 The court stressed that such a result would give greater weight to imputed knowledge than to actual knowledge of a consignee’s practices.68

Other courts rejected, however, the contention that the “generally known” exception was satisfied if a consignor proved only that the competing creditor had actual knowledge of the consignee’s business practices.69 These courts held that the consignor was required to prove that the consignee’s practices were generally known

65 GBS Meat Indus. Pty. Ltd., 474 F. Supp. at 1363; see ATG Aerospace, Inc. v. High-Line Aviation Ltd. (In re High-Line Aviation, Inc.), 149 B.R. 730, 737 (Bankr. N.D. Ga 1992) (finding that actual knowledge of the creditor satisfied the exception, reasoning that the section 1-102 of the UCC allows the Code provisions to be construed liberally to promote its underlying purposes).
66 Belmont Int’l, 831 P.2d at 19.
68 Id.
69 In re BRI Corp., 88 B.R. 71, 75 (Bankr. E.D. Pa. 1988) (finding that evidence of 250 out of 600 suppliers knew the consignee was substantially engaged in the business of selling goods of other was not sufficient to satisfy the “generally known” standard noting that the number may indicate that some, but not most, of the creditors knew).
by a *majority* of its creditors.\(^{70}\) Majority means *most*, not *some*; yet judicial precedent never has established a requisite percentage as the percentage necessary to constitute a *majority*.\(^{71}\) However, one consistent judicial approach has been that the "majority" requirement is determined by looking to the number of creditors that have knowledge, not to the amount of claims.\(^{72}\) Also, courts have not allowed a consignor to include inside-creditors of the consignee as part of the majority, holding that such parties are expected to know.\(^{73}\) The appropriate inquiry is what percentage of outside creditors know of the consignee’s practices.\(^{74}\)

The "generally known" exception also required that the consignor prove that the consignee’s creditors knew that the consignee was *substantially engaged* in selling the goods of others.\(^{75}\) Judicial precedent did not establish what percentage of the debtor’s business had to be consignment sales to satisfy the "substantially engaged" standard, but at least one court found that ten percent was not sufficient to satisfy the standard.\(^{76}\)

### 2. "Sign Law" Exception

Section 2-326(3)(a) provided that consignors could avoid claims of consignee’s creditors if they “complie[d] with an applicable law providing for a consignor’s interest or the like to be evidenced by a sign.”\(^{77}\) Under the sign law, consignors could avoid claims of competing creditors if the consignee posted a sign on its premise

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\(^{71}\) In re BRI Corp., 88 B.R. at 75.

\(^{72}\) In re Wicaco Mach. Corp., 49 B.R. at 344 (holding that one-fifth of creditors knowing about the consignee’s practices was not sufficient to satisfy the “generally known” standard even though the 1/5 held “sixty-three percent of the claims against the debtor”).

\(^{73}\) In re Alper-Richman Furs, Ltd., 147 B.R. at 149–50.

\(^{74}\) Id. at 150.


\(^{76}\) Id.

notifying parties it was selling consigned goods.\textsuperscript{78} However, the sign law provision was not available in those jurisdictions that did not have sign laws.\textsuperscript{79}

3. “Compliance with Section 9-114” Exception

Section 2-326(3)(c) was another exception that garnered some confusion that created uncertainty. It provided that a consignor could avoid the claims of consignee’s creditors if it complied with former section 9-114.\textsuperscript{80} And section 9-114 provided that a consignor would have priority over a perfected secured party, if the consignor had filed a financing statement before the consignee took possession of the goods and had sent notification of its consignment to the competing secured party before the consignee received possession.\textsuperscript{81} Section 9-114 mirrored the former Article 9 priority rule for purchase money security interests, thereby effectively treating the consignor as a purchase money secured party, which could prevail against conflicting security interests in the consigned goods by satisfying the same requirements a purchase money secured party had to satisfy to have priority in inventory.\textsuperscript{82}

The confusion surrounding the application of section 9-114 involved the language of the provision. Section 9-114(1) provided that a consignor would have priority over competing perfected creditors if section 2-326(3) required it to file under Article 9, and if it complied with section 9-114 filing and notice requirements.\textsuperscript{83} Courts questioned whether the priority language in section 9-114

\textsuperscript{79} Id.
\textsuperscript{81} U.C.C. § 9-114 (1999) (AM. LAW INST. & UNIF. LAW COMM’N, amended 1999). § 9-114 also provided the consignor priority in cash proceeds generated from the disposition of the consigned goods provided the cash was received on or before delivery of the goods to the buyer. Id.
\textsuperscript{82} Id. § 9-312(3); In re State St. Auto Sales, Inc., 81 B.R. at 217 (noting that, “the section parallels the filing requirements governing purchase money secured lenders under [former Article 9] § 9-312(3)”).
had removed the priority question from Article 2, placing it instead within the scope of Article 9, effectively vitiating the other section 2-326(3) exceptions. Despite the confusion, courts and commentators held that the most feasible interpretation of section 9-114 was to restrict its application to situations where filing a financing statement was the only effective method for a consignor to assert priority over competing creditors.

C. “Sale or Return” v. “Consignment Intended as Security”

Another area of confusion regarding consignments with which courts struggled was whether the consignment agreement was a “sale or return” or a “consignment intended as security.” Former section 1-201(b)(37) provided that the reservation of title by a consignor was not a security interest in consigned good unless the consignment was intended as security. And section 9-102(2) stated that Article 9 governed “security interest created by contract including ... consignment intended as security.” Consequently, if the consigned goods were intended as security Article 9, rather than Article 2, would apply. The jurisprudential confusion centered on how to determine whether a consignment was a “sale or return,” rather than a “consignment intended as security.”

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84 In re Alper-Richman Furs, Ltd., 147 B.R. at 149–50 (holding that the section 9-114 exception only applies if neither of the other two 2-326 exceptions do not apply); BFC Chems., Inc. v. Smith-Douglass, Inc., 46 B.R. 1009, 1019–20 (E.D.N.C. 1985).
86 Hicinbothem, supra note 3, at 63–66; see Barber v. McCord Auto Supply, Inc. (In re Pearson Indus., Inc.), 47 B.R. 914, 927 (Bankr. C.D. Ill. 1992) (noting that “[t]he problem of whether a particular transaction is a ‘sale or return’ or a ‘consignment’ transaction in which the seller retained title is one that has plagued the courts for years. The problem has been complicated by the fact that some sellers have drawn deliberately ambiguous agreements.”).
88 Id. § 9-102(2) (1999).
90 Hicinbothem, supra note 3, at 63–66.
Courts formulated various tests to ascertain whether a consignment was a “sale or return” rather than a “consignment intended as security.”\textsuperscript{91} The most predominant tests involved examining the facts and circumstances surrounding the transactions to construe the parties’ intentions with a goal towards ascertaining if the transaction involved an agency relationship traditionally associated with consignments or an outright sale on a secured basis.\textsuperscript{92} Some courts found that a consignment was really a security interest securing an obligation if the consignee was obligated to purchase the goods if it could not resell them.\textsuperscript{93} These courts reasoned that a true consignment consists of an agency relationship with the consignor—the principal—at all times retaining control of the consigned goods.\textsuperscript{94} Conversely, if the consignee was required to purchase the item, it became the owner to whom title was transferred.\textsuperscript{95} As such, the consignor’s interest in the consigned goods was at best relegated to that of an enforceable security interest, provided it had complied with the attachment provisions of Article 9.\textsuperscript{96} Thus, Article 9, not Article 2, governed such transactions.\textsuperscript{97}

Other courts applied an all-inclusive approach by analyzing the economic realities of the transactions to determine the intent of the consignment parties.\textsuperscript{98} Intent was determined by an objective standard that assessed the economic realities of the transaction by analyzing who retained control of the consigned goods, whether the goods were commingled with goods owned by the consignee, and which party set the price for the consigned goods.\textsuperscript{99}

\begin{footnotes}
\textsuperscript{91} Id.
\textsuperscript{92} Id.; see Strickland Div. of Rebel Lumber Co., 437 So. 2d at 1244.
\textsuperscript{93} Edmonson v. Caldwell (In re Phippens), 4 B.R. 155, 158–59 (Bankr. M.D. Tenn. 1980).
\textsuperscript{94} Strickland Div. of Rebel Lumber Co., 437 So. 2d at 1244.
\textsuperscript{95} Id. (concluding that that the consignment agreement was “intended as a security interest” noting that the agreement provided that each shipment of consigned goods was described as a “purchase agreement”).
\textsuperscript{96} Id.
\textsuperscript{97} Id.
\textsuperscript{99} Strickland Div. of Rebel Lumber Co., 437 So. 2d at 1244–45; In re Ide Jewelry Co., 75 B.R. at 977.
\end{footnotes}
Courts also focused on the economic function of the consignment. Factors supporting the existence of a true consignment included: (1) the consignor retaining control of the price at which the consigned goods were sold; (2) the consignor retaining the right to recall the goods; (3) the consignee only having the authority to sell consigned goods upon the express consent of the consignor; (4) the consignee’s payment being in the form of a commission rather than a profit; and (5) the storing of the consigned goods separate from the consignee’s inventory. In contrast, factors supporting the existence of a consignment as a security interest involved the consignee: (1) having the right to set the price of the consigned good; (2) commingling the proceeds generated from the sale of consigned goods with proceeds from the sale of its own inventory; and (3) mixing the consigned goods with its own inventory; and it involved the consignor: (1) billing the consignee for the goods once the goods were shipped to the consignee and (2) purporting to retain a security interest in the consigned goods.

In *GECC v. Strickland Division of Rebel Lumber Company*, the Supreme Court of Alabama used the all-inclusive approach in concluding that a purported consignment was really a consignment intended as a security interest after reviewing the consignment agreement, which the court stated contained certain indicia that supported its finding. The agreement provided that the consignee “was allowed to keep whatever profit he was able to charge over the wholesale price and he was absolutely obligated to pay [the consignor] a 5% upcharge even if he was unable to sell the [consigned goods].” The agreement also described each shipment as a “purchase agreement.” The court concluded that the consignee was not acting as an agent of the consignor, “but, to the contrary, [the indicia] supported a finding that ... the consignment agreement was the functional equivalent” of a floor plan arrangement.

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100 *Strickland Div. of Rebel Lumber Co.*, 437 So. 2d at 1244–45; *In re Ide Jewelry Co.*, 75 B.R. at 978.
101 *In re Ide Jewelry Co.*, 75 B.R. at 969, 978.
102 *Strickland Div. of Rebel Lumber Co.*, 437 So. 2d at 1244–45; *In re Ide Jewelry Co.*, 75 B.R. at 978.
103 *Strickland Div. of Rebel Lumber Co.*, 437 So. 2d at 1244–45.
104 *Id.*
105 *Id.*
106 *Id.*
IV. UCC REVISED ARTICLE 9 TREATMENT OF CONSIGNMENT LAW

A. Introduction

In response to persistent criticism that section 2-326 was not a model of clarity, in 1999, the UCC revised Articles 1, 2, and 9 with a goal towards providing greater clarity and uniformity to the law of consignments.\textsuperscript{107} The 1999 revisions sought to clarify section 2-326 “in most cases without changing the rights of the creditors of the consignee.”\textsuperscript{108} The UCC removed commercial consignments from section 2-326, placing them instead within the scope of Article 9, provided they satisfied the Article 9 consignment definition found in section 9-102(a)(20).\textsuperscript{109} Comment 4 to Revised Article 2-326 provides that, “[c]ertain true consignments 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.”\textsuperscript{110}

Section 9-102 (a) (2) provides a comprehensive definition for consignments that incorporates much of the former section 2-326 provisions.\textsuperscript{111} The section defines an Article 9 consignment as “a transaction ... in which a person delivers goods to a merchant for the purpose of sale” and:

\begin{itemize}
  \item[(A)] The merchant:
    \begin{itemize}
      \item[(1)] Deals in goods of that kind under a name other than the name of the person making delivery;
      \item[(2)] Is not an auctioneer; and
      \item[(3)] Is not generally known by its creditors to be substantially engaged in selling the goods of others;
    \end{itemize}
  \item[(B)] With respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery;
\end{itemize}

\textsuperscript{107} PEB COMMENTARY DRAFT, supra note 9, at 1.
\textsuperscript{108} Id.
\textsuperscript{109} In re Haley & Steele, No. 051617BLS, 2005 WL 3489869, at *4 (Mass. Sup. Ct. 2005); see JAMES J. WHITE & ROBERT S. SUMMERS, COMMERCIAL LAW § 22-4 at 1166 (6th ed. 2010) [hereinafter WHITE & SUMMERS, COMMERCIAL LAW] (stating that “the combination of 9-102(a)(20) and 1-201(b)(35) has moved almost all commercial consignments into Article 9—at least for most purposes.”); see also Excel Bank v. Nat’l Bank of Kansas City, 290 S.W.3d 801, 804–05 (Mo. Ct. App. 2009).
\textsuperscript{110} U.C.C. § 2-326 cmt. 4 (AM. LAW INST. & UNIF. LAW COMM’N 2017).
\textsuperscript{111} Excel Bank, 290 S.W.3d at 805.
(C) The goods are not consumer goods immediately before delivery; and
(D) The transaction does not create a security interest that secures an obligation.\textsuperscript{112}

Like former section 2-326, revised section 9-102(a)(20) was adopted to protect creditors from hidden liens resulting from undisclosed consignment agreements.\textsuperscript{113} Official Comment 2 to section 9-319 states that, “[i]nsofar as creditors of the consignee are concerned, this Article to a considerable extent reformulates the former law, which appeared in former sections 2-326 and 9-114, without changing the results.”\textsuperscript{114} For example, section 9-102(a)(20)(A)(i) mirrors the former 2-326(3) provision that required that the consignee to which the goods are delivered deal in goods of that kind in a name other than the consignor.\textsuperscript{115} And section 9-102(a)(20)(A)(iii) mirrors the “generally known by creditors” requirement in former section 2-326(3)(b).\textsuperscript{116}

However, two primary distinctions exist between former 2-326 and current 9-102(a)(20). Former section 2-326 protected consignors against consignee creditor claims if the state had a sign law and the consignee posted a sign notifying parties of its consignment practices, or if the consignor complied with section 9-114.\textsuperscript{117} But section 9-102(a)(20) does not provide for such protections; instead, it requires the consigner to file a financing statement to be shielded from claims of a consignee’s creditors.\textsuperscript{118} Section 9-102(a)(20) also differs from former section 2-326 with

\textsuperscript{112}U.C.C. § 9-102(a)(20) (AM. LAW INST. & UNIF. LAW COMM’N 2017).
\textsuperscript{113}Excel Bank, 290 S.W.3d at 807; French Design Jewelry, Inc. v. Downey Creations, LLC (In re Downey Creations, LLC), 414 B.R. 463, 469 (Bankr. S.D. Ind. 2009).
\textsuperscript{114}U.C.C. § 9-319 cmt. 2 (AM. LAW INST. & UNIF. LAW COMM’N 2017).
\textsuperscript{115}Id. § 9-102(a)(20)(A)(i).
\textsuperscript{116}Id. § 9-102(a)(20)(A)(iii); see Excel Bank, 290 S.W.3d at 806.
\textsuperscript{117}U.C.C. § 2-326(3)(a) (1999) (AM. LAW INST. & UNIF. LAW COMM’N, amended 1999); see Excel Bank, 290 S.W.3d at 807 (noting that “[t]he primary difference after the 1999 revisions is that consignors may no longer rely on notice through the posting of signs and/or written notifications to other creditors, see former §§ 2-326(3) & 9-114, and they must now file a financing statement to protect their interests, see §§§ 9-103(d), 9-310, & 9-311.”)
\textsuperscript{118}See Excel Bank, 290 S.W.3d at 807 (noting that “drafters of the UCC ... chose to remove the additional provisions that allowed consignors to protect their interests through actual and constructive notice and, instead, required them to file a UCC financing statement to protect their interest”).
its addition of subsections B and C, both of which statutorily “exclude transactions for which filing would be inappropriate or of insufficient benefit to justify the costs.” And another difference is that section 9-102(a)(20)(D) specifically provides that consignments “intended as security interest” are not Article 9 consignments.

B. Article 9 Consignments

1. Consignors’ Interests in Consigned Goods

Consignors whose consignment agreements qualify as Article 9 consignments under 9-102(a)(20) must comply with Article 9 perfection and priority rules to prevail against competing secured parties that are creditors of the consignee. Section 1-201(b)(35) facilitates a consignor’s compliance with Article 9 by providing that a consignor’s interest in consigned goods is a security interest; however, the security interest designation does not change the relationship between the consignor and consignee. And section 9-103(d) provides that the security interest is a purchase money security interest. A consignor can best protect its interest by filing a financing statement to perfect its interest. And whether it files a financing statement dictates its rights vis-à-vis the consignee’s creditors.

119 Id. at 805.
121 Georgetown Steel Co. v. Progress Rail Serv. Corp. (In re Georgetown Steel Co.), 318 B.R. 352, 356 (Bankr. D.S.C. 2004) (noting that “most of the law concerning consignment transactions was governed by Article 2,” but that after the revisions, Article 9 provisions govern most consignments).
122 U.C.C. § 1-201(b)(35) (AM. LAW INST. & UNIF. LAW COMM’N 2017); see IPC (USA), Inc. v. Ellis (In re Pettit Oil Co.), 575 B.R. 905, 911 (B.A.P. 9th Cir. 2017); In re Georgetown Steel Co., 318 B.R. at 356.
123 U.C.C. § 9-103(d) (AM. LAW INST. & UNIF. LAW COMM’N 2017); see also In re Pettit Oil Co., 575 B.R. at 907; Arthur Glick Truck Sales, Inc. v. Stuphen E. Corp., 914 F. Supp. 2d 529, 536 (S.D.N.Y. 2012).
125 In re Pettit Oil Co., 575 B.R. at 911; Arthur Glick Truck Sales, 914 F. Supp. 2d at 541.
a. The Legal Status of an Unperfected Consignor

If a consignor does not perfect its security interest, section 9-319(a), which was adopted as part of the 1999 revisions, provides that the consignee is deemed to have the rights and title of the consignor “for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee.” Even though as between the consignor and consignee the consignor remains the owner of the goods, section 9-319(a) grants the consignee the rights and title of the consignor to transfer interests in the goods to its creditors. Section 9-319(a) grants those rights to the consignee’s creditors to protect them from “undisclosed consignment arrangements with the consignee that create secret liens.”

Effectively, section 9-319(a) creates a legal fiction that enables the consignee’s creditors such as secured parties and judicial lien creditors to attach their interests to the consigned goods as if the consignee possessed title to the goods. The consignee acquires those rights even though as between the consignor and consignee, the consignee only has limited rights. Consequently,

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126 U.C.C. § 9-319(a) (AM. LAW INST. & UNIF. COMM’N 2017). Official Comment 2 to 9-319(a) explicitly indicates that the consignee has such rights if the consignor is unperfected. Id. at cmt. 2; see also In re Pettit Oil Co., 575 B.R. at 910; Arthur Glick Truck Sales, 914 F. Supp. 2d at 542 (holding that once the consignment transaction is executed, the consignee is deemed to have the rights and title of the consignor for purposes of determining the rights of its creditors unless the consignor has filed a financing statement perfecting its security interest).

127 Official Comment 2 provides that the consignee acquires the rights and title of the consignor “even though, as between the parties, [consignor and consignee], 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).” U.C.C. § 9-319 cmt. 2.

128 In re Pettit Oil Co., 575 B.R. at 910.


the consignee’s creditors can attach judicial liens and security interests to consigned goods “while the goods are in the possession of the consignee.”\footnote{Fariba, 100 Cal. Rptr. 3d at 226.}

One question that has arisen concerning section 9-319 is whether the termination of a consignment agreement “insulates the consigned goods from the reach of the consignee’s creditors if the consignor’s interest is unperfected.”\footnote{PEB COMMENTARY DRAFT, \textit{supra} note 9, at 5 n.35.} The answer depends on whether the consignee created a security interest in, or a lien attached to the consigned goods before the goods were returned to the consignor.\footnote{Id. at 5–6.} In \textit{In re Valley Media}, the bankruptcy court for the District of Delaware found that where the consignment agreements were terminated prepetition, the debtor-in-possession did not have any rights to exercise its powers under section 544 (a) (1) of the Bankruptcy Code.\footnote{In re Valley Media, Inc., 279 B.R. at 142–43.} In response to \textit{In re Valley Media}, the PEB Commentary proposed draft provides the following:

\begin{quote}

The termination of a consignment agreement does not \textit{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 unperfected. The suggestion to the contrary in \textit{In re Valley Media, Inc.}, 279 B.R. 105 (Bankr. D. Del. 2002), is incorrect.\footnote{PEB COMMENTARY DRAFT, \textit{supra} note 9, at 5 n.35.} The proposed commentary clarifies that “[a]fter the [consigned] 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.”\footnote{Id. at 5–6.} However, the proposal emphasizes that creditors whose interests attach to consigned goods while they are in the possession of the consignee remain enforceable even after the goods have been returned to the consignor, even though the consignee no longer possesses the goods and no longer has the rights and title of the consignor.\footnote{Id. at 6.}

\end{quote}
The PEB proposes amending Official Comment 2 to 9-319 to include the following:

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.  

*b. The Legal Status of a Perfected Consignor*

Section 9-319(b) provides that law other than Article 9 “determines the rights and title of a consignee” if the consignor has perfected its security interest and has priority under Article 9.  

Most likely, the common law of bailment will govern the rights and titles of the consignee; and it would preclude consignee’s creditors from asserting claims against the consigned goods. To best protect its interest, a consignor must perfect its interest by filing a financing statement before the delivery of the consigned goods to the consignee. In *Arthur Glick Truck Sales*, the federal district court for the Southern District of New York stated that a subsequent filing by the consignor after the execution of the consignment agreement did not prevent the consignee from transferring the consignor’s rights and title to the consignee’s creditors. Even though the consignor subsequently filed a financing statement, the court emphasized that at the time of delivery of the consigned goods, the consignor’s purchase money security interest was unperfected thereby triggering the operation of 9-319(a).

If a consignor timely files its financing statement, it will have priority over the consignee’s secured creditors if it complies with the applicable Article 9 priority rules. To assert priority

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138 *Id.* at 7.
139 U.C.C. § 9-319(b) (AM. LAW INST. & UNIF. LAW COMM’N 2017).
140 *Id.* Section 9-319(b) also defers to the common law of bailment or other state law governing consignments.
143 *Id.*
144 *Id.* at 541.
against a competing secured creditor of the consignee, the consignor must comply with section 9-324(b), which requires that the consignor’s security interest be perfected and that the consignee’s creditor receive notice of the consignor’s interest before the consignee takes possession of the consigned goods.\textsuperscript{145} If the consignor complies with section 9-324(b), it will not only have priority in the consigned goods, but also in any identifiable cash proceeds received by the consignee on or before delivery of the consigned goods to a buyer, along with priority in certain noncash proceeds generated from the sale of the goods.\textsuperscript{146}

The consignor’s perfected status will also grant it priority over judicial lien creditors since section 9-317(a)(1) provides that a perfected party has priority over a lien creditor.\textsuperscript{147}

2. Consignee’s Secured Creditors’ Interests in Consigned Goods

a. Introduction

A secured creditor’s interest in consigned goods of its debtor/consignee will be governed by Article 9 if the consignor has not perfected its security interest nor established priority under Article 9.\textsuperscript{148} But to prevail against a consignor, a secured creditor of the consignee must have a perfected security interest in the consigned good, which requires the creditor to attach and to perfect its security interest.\textsuperscript{149}

b. Attachment of Consigned Goods by a Consignee’s Secured Creditors

A consignee’s creditor must attach its security interest to consigned goods pursuant to section 9-203 to obtain an enforceable

\begin{footnotesize}
\textsuperscript{145} U.C.C. § 9-324(b) (AM. LAW INST. & UNIF. LAW COMM’N 2017); see Liebzeit v. FVTS Acquisition Co. (In re Wolverine Fire Apparatus Co.), 465 B.R. 808, 820 (Bankr. E.D. Wis. 2012).

\textsuperscript{146} U.C.C. § 9-324(b) (AM. LAW INST. & UNIF. LAW COMM’N 2017).

\textsuperscript{147} Id. § 9-317(a); see Kraken Invs. Ltd. v. Jacobs (In re Salander-O’Reilly Galleries, LLC), 506 B.R. 600, 608 (Bankr. S.D.N.Y.), rev’d, No. 14CV3544VB, 2014 WL 7389901, at *1 (S.D.N.Y. Nov. 25, 2014).

\textsuperscript{148} IPC (USA), Inc. v. Ellis (In re Pettit Oil Co.), 575 B.R. 905, 907 (B.A.P. 9th Cir. 2017); In re Salander-O’Reilly Galleries, LLC, 506 B.R. at 605.

\textsuperscript{149} U.C.C. § 9-309 (AM. LAW INST. & UNIF. LAW COMM’N 2017).
\end{footnotesize}
security interest in them.\textsuperscript{150} Section 9-203 requires, among other things, that the debtor have rights in the collateral or power transfer rights and that the security agreement sufficiently describe the collateral securing the obligation.\textsuperscript{151} The section 9-203(b)(2) “power to transfer” element of attachment is satisfied by section 9-319(a), which grants the consignee the power to transfer the rights and title of the consigned goods to its secured creditors while those goods are in its possession.\textsuperscript{152}

However, an issue has arisen whether section 9-319(a) is more than “merely an enabling provision that permits satisfaction of [section 9-203(b)(2)].”\textsuperscript{153} Specifically, can a consignee pursuant to section 9-319(a) grant a security interest in consigned goods even if the security agreement limits the collateral description to property owned by the debtor? Under section 9-203(b)(3)(A), a secured creditor can only attach its security interest to goods covered by the collateral description in the security agreement.\textsuperscript{154} That provision arguably limits the consignee from granting a security interest in consigned goods if the security agreement between it and its secured creditor describe the collateral as only that property owned by the debtor, since the debtor does not own the consigned goods.\textsuperscript{155} Some courts have found, however, that section 9-319(a) enables a consignee to create a security interest in consigned goods even though the security agreement limits the description to property owned by the debtor.\textsuperscript{156}

The few courts that have addressed this issue are divided on whether section 9-319(a)’s grant of consignor’s rights and title to the consignee enables a consignee to grant a security interest in the consigned goods notwithstanding restrictive ownership language in a security agreement that might otherwise prevent

\begin{footnotesize}
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\item \textsuperscript{150} \textit{Id.} § 9-203.
\item \textsuperscript{151} \textit{Id.}
\item \textsuperscript{152} \textit{Id.} § 9-203(b)(2).
\item \textsuperscript{154} U.C.C. § 9-203(b)(3)(A) (AM. LAW INST. & UNIF. LAW COMM’N 2017).
\item \textsuperscript{155} \textit{See} Kraken Invs. Ltd. v. Jacobs (\textit{In re Salander-\textsuperscript{O’Reilly Galleries, LLC}), No. 14CV3544(VB), 2014 WL 7389901, at *3–4 (S.D.N.Y. Nov. 25, 2014).
\item \textsuperscript{156} \textit{See} Woven Treasures, Inc. v. Hudson Capital, LLC, 46 So. 3d 905, 915 (Ala. 2009).
\end{itemize}
\end{footnotesize}
attachment under section 9-203(b)(3)(A). In most of these cases, consignors have contended that section 9-319(a) is inapplicable because a consignee’s creditors cannot attach their security interests to the consigned goods where their security agreements describe the collateral as only that property owned by the debtor. However, most of the courts that have addressed this issue have found the consignors’ arguments unpersuasive. These courts have emphasized section 9-319(a)’s language, which grants the consignee the rights and title of the consignor enabling it to create a security interest in such goods despite the restrictive ownership language in their security agreements.

In Woven Treasures, Inc., the consignor contended that section 9-319(a) was inapplicable since the security agreement described the collateral as “merchandise” and it defined “merchandise” as property owned by the consignee. The Supreme Court of Alabama rejected the consignor’s argument emphasizing that under section 9-319(a) the consignee is “deemed to have rights and title to the goods identical to those the consignor had,” and that the definition of “own” includes rightfully possessing property. The court concluded that TSR Imports as a consignee rightfully possessed the consigned goods thereby enabling it to grant a security interest to its secured creditor. And in Sensient Flavors, LLC, the Michigan Court of Appeals stated that section

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157 In re TSAWD Holdings, Inc., 565 B.R. at 304; Woven Treasures, Inc., 46 So. 3d at 915; Sensient Flavors, LLC v. Crossroads Debt, LLC, No. 302323, 2013 WL 5857604, at *7 (Mich. Ct. App. Oct. 31, 2013). But see In re Salander-O’Reilly Galleries, LLC, 2014 WL 7389901, at *3–4 (holding that Section 9-319(a) does not grant a consignee the power to grant a security interest in consigned goods to its secured creditor if the security agreement describes the collateral as only that property owned by the consignee).
159 In re TSAWD Holdings, Inc., 565 B.R. at 304; Woven Treasures, Inc., 46 So. 3d. at 915.
160 In re TSAWD Holdings, Inc., 565 B.R. at 304; Woven Treasures, Inc., 46 So. 3d at 915.
161 Woven Treasures, Inc., 46 So. 3d at 915.
162 Id.
163 Id.
9-319(a) “allows a consignee to grant a security interest in property that it does not own.” 164

At least one court has found, however, that a consignee’s creditor’s security interest did not attach to consigned goods where the collateral description in the security agreement limited the property to goods *owned* by the consignee. 165 In *In re Salander-O’Reilly Galleries, LLC*, a federal district court for the Southern District of New York found that secured creditor’s security interest did not attach to consigned goods because the collateral description of the loan agreement between consignee/debtor and the bank only granted the bank a security interest in goods *owned or hereinafter acquired* by the consignee/debtor. 166 The case was on appeal from the bankruptcy court, which had denied the consignor’s summary judgment motion in which it argued that the collateral description in the loan agreement only granted the bank a security interest in the artwork owned by the consignee. 167

The federal district court agreed with the consignor’s argument. 168 It held that the plain language of the security agreement provided that a security interest would attach only to personal property “*owned or thereafter owned*” by the consignee, and since the consignor, not the consignee, was the owner of the consigned goods, the secured creditor could not attach its lien to the good. 169 In arriving at this conclusion, the court interpreted the term “hereafter acquired” to include only those goods that the debtor acquired through ownership, instead of through other means, such as consignment, entrustment, or the like. 170 The court’s ruling centered on contract interpretation, which the court concluded was governed by the plain meaning of the contract. 171 According to the court, the plain meaning of the contract clearly indicated that the parties’ intent was only to grant

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166 *Id.*
167 *Id.*
168 *Id.*
169 *Id.*
170 *Id.*
171 *Id.* at *3.*
the bank a security interest in the personal property that its
debtor/consignee owned.172

The court did not address, however, whether the consign-
ment transaction was an Article 9 consignment, so the opinion
did not contain a discussion concerning the legal scope of section
9-319(a).173 The secured creditor had assigned its interest to the
bankruptcy trustee, which had filed a partial summary judgment
motion with the bankruptcy court alleging that the consignment
agreement satisfied the various attributes of section 9-102(a)(20);
but the court found that it had failed to “provide any evidentiary
support for these allegations.”174 The bankruptcy court had de-
nied the trustee’s partial summary judgment motion finding that
material issues of fact existed that precluded judgment for the
trustee.175 The court concluded that the trustee, at trial, would
have the burden of proof with regard to each attribute enumer-
ated in 9-102(a)(20).176 The trustee did not appeal the bankruptcy
court ruling, and the federal district court’s holding was limited
to remanding the case to the bankruptcy court with instructions
to enter summary judgment in favor of the consignor.177

In In re TSAWD Holdings, Inc., the bankruptcy court for the
District of Delaware found the reasoning in In re Salander-O’Reilly
Galleries, LLC to be unpersuasive.178 In the case, a secured cred-
itor of the consignee filed a motion for partial summary judgment
arguing that the consignment qualified as an Article 9 consignment
thereby granting it priority because consignor’s security interest
was unperfected.179 The secured creditor contended that the con-
signee/debtor “would be deemed to have an interest in consigned

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172 Id. at *3–4. In a footnote to the case, the court also indicated that ex-
trinsic evidence proffered by the consignor proved that the parties’ that the loan
be secured only with “dealer owned inventory,” and the court stated that the ex-
trinsic evidence “provides an alternative basis for [its] ruling.” Id. at *5 n.3.

173 Id. at *1–5.

174 Id. at *3. The trustee did not rely on its status as a judicial lien creditor
to assert its claim to the consigned goods. In re Salander-O’Reilly Galleries,
LLC., 506 B.R. at 607. The court indicated that the consignment agreement
had expired apparently prepetition. Id. at 607, 612.

175 Id. at 607.

176 Id. at 609.


178 TSA Stores, Inc. v. M J Soffè, LLC (In re TSAWD Holdings, Inc.), 565

179 Id. at 299.
goods sufficient to grant a security interest to [it] pursuant to section 9-319(a).” 180 Relying on the holding in In re Salander-O'Reilly Galleries, LLC the consignor in In re TSAWD Holdings argued that the consignee’s secured party had not created a security interest in the consigned goods because the security agreement defined the collateral as “property owned by the Debtors [consignees].” 181 The court rejected the consignor’s argument noting that Salander-O'Reilly was distinguishable because it “did not address the issue of material fact (as to whether the consignment agreement was governed by the UCC),” which was the issue before the court in In re TSAWD Holdings, Inc. 182 The court also denied the secured creditors motion for partial summary judgment finding that the “question of whether the UCC is applicable raises a disputed issue of material fact which precludes partial judgment on the pleadings.” 183

The court in In re TSAWD Holdings, Inc. was incorrect in rejecting the consignor’s argument. Contrary to the court’s holding, the In re Salander-O'Reilly Galleries, LLC decision is persuasive. Even if a consignment is governed by Article 9, section 9-319(a) should not be interpreted as granting a consignee the power to create a security interest in consigned goods not covered by the security agreement description. Courts that have found otherwise have misconstrued section 9-319(a). While the PEB Draft Commentary indicates that a consignee has “the rights in and the power to transfer the consigned goods,” it emphasizes that a security interest only becomes enforceable after the “other requirements of section 9-203(b) [have been] satisfied.” 184 The significance of section 9-319(a) should not be understated; but its scope in relation to the rights of secured creditors of a consignee is limited to that of an enabling provision, which permits the satisfaction of section 9-203(b)(2). It does not vitiate the requirement of section 9-203(b)(3), which provides that a security agreement description must cover the consigned goods to create an enforceable security interest. 185 A security agreement is a contract subject to

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180 Id. at 304.
181 Id. at 303.
182 Id. at 304.
183 Id.
184 PEB COMMENTARY DRAFT, supra note 9, at 6.
the principles of contract law. And absent an ambiguity in the contract, a description that limits property to that owned by the consignee plainly signifies the parties’ intent not to grant a security interest in consigned goods in the possession of the consignee.

Nonetheless, the court’s ruling in In re Salander-O’Reilly Galleries, LLC is problematic for secured lenders, which often describe collateral as inventory “whether now owned and hereafter acquired.” After the ruling, secured lenders will need to eliminate the “ownership” reference in security agreements and financing statement descriptions to reach consigned goods. Clarks’ Secured Transactions Monthly suggests that secured creditors considering describing the collateral in the financings statement as follows: “All assets in which the debtor now has or hereafter acquires rights or the power to transfer rights,” and describing the collateral in the security agreement as “all inventory, accounts, equipment, and general intangibles, whether the debtor currently has or hereafter acquires rights (or the power to transfer rights) in the foregoing.”

c. Perfection of, and Priority in Consigned Goods by Consignee’s Secured Creditors

Even if a consignee’s creditor successfully attaches its security interest to the consigned goods, it must perfect its security interest to prevail against an unperfected consignor. One common means of perfection is by filing a financing statement. To avoid the result reached in In re Salander-O’Reilly Galleries, LLC, a secured creditor should avoid restrictive collateral descriptions in its financing statement that limit collateral to property

186 Id. § 9-204(d).
189 Id. at 2.
190 Id.
191 U.C.C. § 9-322(a)(2) (AM. LAW INST. & UNIF. LAW COMM’N 2017). If the consignee’s creditor is unperfected then priority will be determined based on which party attached first, in which case the consignor will prevail since its interest is automatic under Section 1-201(b)(35). See id. § 9-322(a)(3).
owned by the consignee. Assuming its financing statement sufficiently describes the consigned goods, a consignee’s creditor will have priority over an unperfected consignor pursuant to section 9-322(a)(2), which grants priority to a perfected secured creditor over an unperfected one.193

3. Judicial Lien Creditors’ Attachment of Consigned Goods

Section 9-319(a) applies also to judicial lien creditors such as bankruptcy trustees, which can attach liens to consigned goods as hypothetical lien creditors pursuant to section 544(a)(1) of the Bankruptcy Code.194 In effect, “[t]he trustee hypothetically extends credit to the debtor at the time of [bankruptcy petition] filing and, at that moment, obtains a judicial lien on all property in which the debtor has any interest that could be reached by a creditor.”195 Moreover, a debtor-in-possession assumes the rights of the hypothetical lien creditor under section 544(a)(1) to act for the benefit of the bankruptcy’s estate creditors, even though in its role as the consignee, it does not have any power to avoid an unperfected security interest of its consignor.196 The knowledge of a pre-petition debtor regarding the existence of consignment arrangements is not imputed to a debtor-in-possession in a bankruptcy.197

Section 9-317(a)(2) grants lien creditors such as bankruptcy trustees priority over unperfected security interest, thereby allowing

195 In re Salander-O’Reilly Galleries, LLC, 475 B.R. at 22 (quoting Musso v. Ostashko, 468 F.3d 99, 104 (2d Cir. 2006)).
196 French Design Jewelry, Inc. v. Downey Creations, LLC (In re Downey Creations, LLC), 414 B.R. 463, 473 (Bankr. S.D. Ind. 2009) (noting that Article 9 is only relevant to the consignee’s dispute because its Chapter 11 bankruptcy filing places it in the “shoes of a hypothetical lien creditor’’); see also In re Valley Media, Inc., 279 B.R. 105, 132 (Bankr. D. Del. 2002); In re G.S. Distribution, 331 B.R. 552, 561 (Bankr. S.D.N.Y. 2005) (noting that a “consignor must ordinarily file a financing statement in order to protect its interest in the property from the claims of a bankruptcy trustee or debtor in possession acting on behalf of the estate’s creditors under the ‘strong arms powers’ of § 544 of the Bankruptcy Code’).
them to avoid a consignor’s unperfected security interest.\textsuperscript{198} It is worth noting that the ruling in \textit{In re Salander-O'Reilly Galleries, LLC} would not affect judicial lien creditors since their interests in the consigned goods is statutorily, not contract, based.\textsuperscript{199} However, neither a trustee nor a debtor-in-possession can assert the avoidance powers under section 544(a)(1) if the consigned goods have been returned to the consignor before the petition filing.\textsuperscript{200}

To protect their interests against trustees and debtors-in-possession asserting avoidance powers under section 544(a)(1), consignors need to perfect their security interest.\textsuperscript{201}

V. JUDICIAL TREATMENT OF ARTICLE 9 CONSIGNMENT LAW

A. Introduction

As courts have begun to apply Revised Article 9 to determine whether a consignee’s creditors can assert claims to consigned goods they continue to wrestle with some of the same issues courts encountered when analyzing whether consignments qualified as “sale and return” transactions under former section 2-326.\textsuperscript{202} In large part, courts are confronted with many of the same issues because Article 9, in many respects, is a reformulation of former section 2-326. In addition, the Article 9 revisions have generated new issues. For the most part, the issues fall generally into one of the following three categories: (1) What qualifies as an Article


\textsuperscript{199} The trustee did not rely on its status as a judicial lien creditor to assert its claim to the consigned goods. \textit{In re Salander-O'Reilly Galleries, LLC}, 506 B.R. at 607. The court indicated that the consignment agreement had expired apparently pre-petition. \textit{Id.} at 607, 612.

\textsuperscript{200} PEB COMMENTARY DRAFT, supra note 9, at 6; see also \textit{In re Salander-O'Reilly Galleries, LLC}, 506 B.R. at 612 (allowing the trustee to assert an interest in consigned goods even though the consignment expired pre-petition, because the trustee was not seeking to avoid the consignor’s interest pursuant to the strong arm clause of section 544(a)(1), but rather asserting its interest as an assignee of one of the consignee’s secured creditors whose security interest had attached to the consigned goods prior to the petition filing).

\textsuperscript{201} French Design Jewelry, Inc. v. Downey Creations, LLC (\textit{In re Downey Creations, LLC}), 414 B.R. 463, 467 (Bankr. S.D. Ind. 2009).

\textsuperscript{202} PEB COMMENTARY DRAFT, supra note 9, at 1.
9 consignment;\textsuperscript{203} (2) Who has the burden of proving that a consignment agreement qualifies as an Article 9 consignment;\textsuperscript{204} and (3) What law governs if the consignment does not qualify as an Article 9 consignment.\textsuperscript{205}

Much of the confusion surrounding the first issue involves interpreting the various elements section 9-102(a)(20) in a manner that most efficaciously serves the underlying goals the UCC sought to achieve in placing consignments within the scope of Article 9.\textsuperscript{206} The second issue concerning the burden of proof is one on which courts are also split.\textsuperscript{207} Former section 2-326 explicitly provided that the consignor had to prove it qualified for one of three section 2-326 exceptions to avoid claims of a consignee’s creditors.\textsuperscript{208} Revised Article 9 is silent on the issue, but the phraseology of several of the section 9-102(a)(20) elements suggests that the burden is on the party seeking protection under the section.\textsuperscript{209} The third issue concerning what law governs if the consignment does not qualify as an Article 9 consignment has confounded some courts, which have found that such consignments should be governed by revised section 2-326, even though Official Comment 4 to that section explicitly states that true consignments dealt with under former section 2-326 have been replaced by new provisions in Article 9.\textsuperscript{210}

This section of the Article will examine post-1999 judicial treatment concerning each of the above-mentioned issues.

**B. What Qualifies as an Article 9 Consignment?**

Courts have been presented with the following issues concerning whether a consignment agreement qualifies as an Article 9 consignment: (1) Whether the goods have been delivered “to a
merchant for the purpose of sale;”211 (2) Whether the merchant “deals in goods of that kind under a name” other than the consignor;212 (3) Whether “it is not generally known by” the merchant’s creditors that the merchant is “substantially engaged in selling the goods of others;”213 (4) Whether the consignment is a consumer consignment excluded from Article 9;214 and (5) Whether the transaction “create[s] a security interest that secures an obligation.”215

1. Delivery to a “Merchant for the Purpose of Sale”216

To qualify as an Article 9 consignment the delivery of goods to the merchant must be for the purpose of sale.217 As such, true bailments are excluded from the scope of Article 9 consignments since bailment agreements do not allow the bailee to sell the good delivered.218 In In re Greenline Equipment, Inc., the bankruptcy court for the Northern District of Mississippi concluded that delivery of equipment to a merchant for storage with an occasional infrequent sale by the merchant to a third party was not a delivery “for the purpose of sale.”219 The owner of the goods, Foster Brothers, delivered its equipment for temporary storage, and on an infrequent basis, the equipment was purchased by a third party.220 The court concluded that the delivery of goods at best involved a bailment agreement in which the identical thing delivered was returned after the purpose of the bailment had been fulfilled.221 And it viewed the occasional infrequent sales as incidental, not as consignment sales.222

211 Id.
212 Id. § 9-102(a)(20).
213 Id.
214 Id. § 9-102(a)(20) cmt. 14.
215 Id. § 9-102(a)(20)(D).
216 Id. § 9-102(a)(20).
217 Id.; see also JP Morgan Chase Bank, N.A., v. AVCO Corp. (In re Citation Corp.), 349 B.R. 290, 295 (Bankr. N.D. Ala. 2006).
218 In re Citation Corp., 349 B.R. at 295–96.
216 Id. at 580.
221 Id. at 581.
222 Id.
a. The Delivery of Raw Materials to Be Processed

One recurring issue with which courts have been presented is whether the delivery of raw materials to a merchant that subsequently incorporates the raw materials into a final product, either through manufacturing or processing, is a delivery “for the purpose of sale.” Generally, consignment agreements involving the delivery of raw material provide that the materials will be segregated from the merchant’s inventory until such time as the material is ready for processing. During its storage in a segregated area, the consignee is not obliged to pay for the goods. Only after the consignee moves the raw materials from the segregated area for processing or manufacturing is the consignee invoiced for the price of the materials it processes.

White and Summers have referred to these transactions as “quasi-consignments” and have stated the following regarding whether the delivery of raw materials is a “delivery to a merchant for the purpose of sale”:

The definition of “consignment” requires that the goods be delivered “to a merchant for the purpose of sale.” If the goods are delivered for another purpose as well, such as milling or

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223 Georgetown Steel Co. v. Progress Rail Servs. Corp. (In re Georgetown Steel Co.), 318 B.R. 352, 358 (Bankr. D.S.C. 2004) (finding that delivery of HBI, a component of steel, to the consignee which processed it into steel, was a delivery for the purpose of sale since the HBI was an integral component of the steel that the consigne sold to its customers); see Barber v. McCord Auto Supply, Inc. (In re Pearson Indus., Inc.), 147 B.R. 914, 927 (Bankr. S.D. Ill. 1992) (finding that the sale of a component part was covered by Section 2-326).

224 Samuel & Son Co. v. Excalibur Mach. Co. (In re Excalibur Mach. Co.), 404 B.R. 834, 838 (Bankr. W.D. Pa. 2009); In re Georgetown Steel Co., 318 B.R. at 354–55 (noting that raw materials were maintained in a segregated area until processing at which point the consignee had to pay for the materials it processed); Sensient Flavors, LLC v. Crossroads Debt, LLC, No. 302323, 2013 WL 5857604, at *1–2 (Mich. Ct. App. Oct. 31, 2013) (noting that the cherries were maintained in a storage pit until such time as they were processed at which time the consignee was deemed to have purchased the cherries).


227 WHITE & SUMMERS, COMMERCIAL LAW, supra note 109, § 22-5 at 116–69.
processing, the transaction is a consignment nonetheless because a purpose of the delivery is “sale.”  

And generally, courts have found that the delivery of raw materials is a delivery “for the purpose of sale.”  

Georgetown Steel is an oft-cited case in which the bankruptcy court for the District of South Carolina found that the delivery of HBI, a component of steel, to the consignee, which processed it into steel, was a delivery for the purpose of sale, since the HBI was an integral component of the steel that the consignee sold to its customers. In In re Georgetown Steel Co., LLC, the owner delivered the HBI to the consignee, which stored it in a segregated location for its own inventory and transferred it as needed for processing into steel. On a weekly basis, the consignee would report its usage of HBI to the consignor and would pay the consignor for the amount it had consumed. In concluding that the delivery of raw materials was a delivery “for the purpose of sale,” the court referenced to both Official Comment 14 accompanying the Alabama version of the UCC, which mirrors the UCC Official Comment, and White and Summers noting that both sources contemplate that the delivery of such goods is a delivery for the “purpose of sale.” Official Comment 14 accompanying section 9-102(a)(20) provides that:

The definition of “consignment” requires that goods be delivered “to a merchant for the purpose of sale.” If the goods are delivered for another purpose as well, such as milling or processing, the transaction is a consignment nonetheless because a purpose of delivery is sale.

However, not all courts have followed the guidance provided in the Official Comments. In In re Excalibur Machine, the bankruptcy court for the Western District of Pennsylvania

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228 Id. at 1169 (emphasis added).
230 In re Georgetown Steel Co., 318 B.R. at 354.
231 Id.
232 Id.
233 Id. at 358.
235 PEB COMMENTARY DRAFT, supra note 9, at 3–4.
found that the delivery of raw materials constituted a consignment transaction, but that the subsequent sale of the finished product by the merchant was a sales transaction governed by section 2-401.\textsuperscript{236} The court held that a consignment agreement existed between the parties while the raw materials were in storage, but concluded that their relationship became that of debtor and creditor amounting to a sales transaction once the raw materials were transferred for processing.\textsuperscript{237}

In \textit{In re Excalibur Machine}, the consignor delivered steel plates to be used in the consignee’s manufacturing process.\textsuperscript{238} Similar to other consignments involving the delivery of raw materials, the consignee stored the steel plates in a segregated area until such time as it used them in the manufacturing process.\textsuperscript{239} Once the steel plates were transported from the segregated area for processing, the consignor invoiced the consignee for the consigned goods.\textsuperscript{240} Subsequently, the consignee processed the steel plates into a finished product, which it sold on account to its customers.\textsuperscript{241} The consignor claimed a priority interest in the accounts receivables.\textsuperscript{242}

The consignment agreement was entitled a “Consignment Security Agreement,” which granted the consignor a “continuing security interest in the Consigned Goods.”\textsuperscript{243} The consignor also filed a financing statement that expanded the collateral description to include consigned goods, including, but not limited to, the consigned steel plates.\textsuperscript{244} The court narrowly interpreted the “consigned goods” description in the consignment security agreement to include only the raw materials.\textsuperscript{245} Even though the court recognized that the financing statement description “attempted to expand the scope” of the consigned goods to include the finished

\textsuperscript{237} Id.
\textsuperscript{238} Id. at 838.
\textsuperscript{239} Id.
\textsuperscript{240} Id.
\textsuperscript{241} Id.
\textsuperscript{242} Id.
\textsuperscript{243} Id. at 837.
\textsuperscript{244} Id.
\textsuperscript{245} Id. at 840.
product, it emphasized that the language of the security agreement, not the financing statement, determined the parties’ intent.\(^{246}\) And the court viewed the collateral description in the security agreement as intending only to grant a security interest in the “raw material that remained in segregated storage on the [consignee’s] premises and the proceeds of any sale of those raw materials to third parties.”\(^{247}\)

Accordingly, the court found that the relationship between the parties “changed when [the consignee] took the raw steel into its facility [for processing].”\(^{248}\) Once the steel was transferred for processing a “relationship of debtor and creditor existed, rather than that of consignor and consignee” because at that point “there was an agreement to pay a specific amount” resulting in a sale.\(^{249}\) The court concluded that once the consignee incorporated the steel plates into its product, it was no longer segregated, and that the consignee handled the purchased steel plate as its own.\(^{250}\) And the purchased steel plates became the property of the consignee subject to claims of its creditors.\(^ {251}\) The court proceeded to apply Article 2, which governs the sale of goods, noting that under New York UCC section 2-401, title passes from the seller to a buyer once “the seller completes its performance with respect to physical delivery of the goods.”\(^ {252}\) Emphasizing that the consignor’s perfected security interest was limited to the steel plates in the segregated area, the court concluded that the consignor did not have an interest in accounts receivable proceeds that the consignee had received from the sale of the finished product.\(^ {253}\)

It is confounding that the court concluded that the parties only intended to execute a consignment agreement with respect to the raw materials. By itself, the delivery of the raw materials could not qualify as a consignment arrangement.\(^ {254}\) In a consignment arrangement, the merchant to whom the goods are delivered

\(^{246}\) Id.

\(^{247}\) Id.

\(^{248}\) Id. at 839.

\(^{249}\) Id. at 839–40.

\(^{250}\) Id. at 839.

\(^{251}\) Id. at 840.

\(^{252}\) Id. at 839.

\(^{253}\) Id. at 840.

agrees to sell the delivered goods to a third party. The merchant in *Excalibur* had no intention of selling the steel plates to third parties. Rather, the merchant and the owner of the steel plates intended that the merchant sell the finished product to third parties, which suggests that the parties intended the term “consigned goods” to include the finished product.

The court’s approach clearly undermines the goals of Article 9 to provide greater clarity and uniformity regarding the respective rights of consignors and creditors of consignees. As required by Article 9, the consignor in *In re Excalibur Mach. Co.* dutifully filed its financing statement to protect its interest against the consignee’s creditors. Despite its diligence in filing, the consignor’s interest was subordinated to both the competing consignee creditor and the consignee, which was a debtor-in-possession. In this respect, the court’s ruling provided a windfall to both the debtor-in-possession and its secured creditor, while inequitably penalizing the consignor. Article 9 consignment rules were devised to provide priority to consignees’ creditors when undisclosed consignment agreements created secret liens on what appeared to the creditors as consignee’s inventory. But no secret liens existed in this case. The consignor had filed a financing statement, which gave the consignee’s creditors notice of the consignment. The court’s subordination of the consignor’s interest reflects a complete lack of appreciation for the legal framework devised by Article 9 to protect the respective rights of the consignor and competing creditors of the consignee.

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256 *Id.*
257 Interestingly, the court’s ruling does not address whether the consignor would have been more successful if its description in the consignment agreement and financing statement would have included specifically all final products into which steel plates are incorporated. However, the Official Comment 14 to Section 9-102(a)(20) does not require such specification. U.C.C. § 9-102 cmt. 14 (AM. LAW INST. & UNIF. LAW COMM’N 2017).
261 See *id.*
264 *Id.* at 838.
Another issue concerning the delivery of raw materials is whether the “purpose for sale” requirement is satisfied if the finished product is sold back to the consignor rather than to a third party. Section 9-102(a)(20) does not specifically require that the merchant sell the consigned goods to someone other than its owner, but the most sensible interpretation of the provision is that merchant must sell the goods to a third party, rather than to the owner.265 By its very definition, consignments involve owners delivering goods to a merchant for resell to third parties.266 Owners consign their goods to merchants to secure a market in which to sell them, which indicates their intent to sell their goods to third parties, rather than back to themselves.267

Generally, courts have found that the delivery of raw materials to be incorporated into a finished product to be sold back to the owner is not a consignment.268 Consistent with the judicial opinion, White and Summers have stated that: “If despite their processing and commingling, the goods are returned to the owner and not sold to a third person, the transaction is not a consignment under 1999 Article 9 ....”269

Courts have viewed these such transactions as true bailments, not consignment transactions.270 In Citation, the bankruptcy court for the Northern District of Alabama found that a bailment contract existed between parties when the owner of steel delivered it to a manufacturer to produce airplane crankshafts with the instruction that all crankshafts produced were to be sold to the owner.271 The court emphasized that the merchant never purchased the raw materials and the agreement only allowed the merchant to sell the finished product back to the owner of the steel.272 And at all times, the title remained with the owner.273 Even though variations of the term “consign” appeared sixty-eight times in the contract, the court stated, “that the term alone was

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266 Id. § 9-102 cmt. 14.
268 See JP Morgan Chase Bank, N.A. v. AVCO Corp. (In re Citation Corp.), 349 B.R. 290, 296–97 (Bankr. N.D. Ala. 2006).
269 WHITE & SUMMERS, COMMERCIAL LAW, supra note 109, § 22-5 at 1169.
270 See In re Citation Corp., 349 B.R. at 297.
271 Id.
272 Id. at 291.
273 Id. at 292.
not ‘magical.’” The court found no evidence in the agreement that the intent of the parties was to create a consignment agreement subject to the UCC.

But at least one court has found that the delivery of raw materials incorporated into a finished product that was sold back subsequently to the owner of the raw materials was a delivery “for the purpose of sale.” In Sensient Flavors, the Michigan Court of Appeals found that Sensient’s delivery of raw materials consisting of raw cherries, coloring, and flavoring to a Cherry Blossom with the understanding that the Cherry Blossom would process the raw materials and sell the finished product back to the Sensient involved a delivery “for the purpose of sale.” Sensient maintained a weekly account of the costs of the delivered materials and setoff weekly from the purchase price of the finished product the price of the raw cherries, colorings, and flavorings that Cherry Blossom had purchased from Sensient.

In concluding that the cherries were delivered to the consignee “for the purpose of sale,” the court analogized the arrangement between Sensient and Cherry Blossom to the consignment arrangement in Georgetown Steel in which a bankruptcy court found that the delivery of raw materials subsequently processed into a finished product and sold to third parties was a delivery “for the purpose of sale.” In its analogy, the court minimalized the most significant distinction between Georgetown and Sensient, the former involved the sale of the finished products to third parties, while the latter involved the consignee selling the finished product back to the consignor. The court diminished the distinction by stating that, “the cherries were delivered to Cherry Blossom for the purpose of sale, regardless of the fact that the sale was back to Sensient [the owner of the cherries].”

The court’s reliance on Georgetown Steel is misplaced. Having mistakenly determined that the transaction was an Article 9

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274 Id. at 296.
275 Id.
277 Id.
278 Id. at *2.
279 Id. at *7.
280 Id.
281 Id. (emphasis added).
consignment, the court held that the consignee’s secured creditor had priority in the cherries, thereby subordinating the consignor’s unperfected security interest.\textsuperscript{282} The court should have analyzed the parties’ rights under the common law, which is essentially the law of bailment, which would have granted priority to the consignor.\textsuperscript{283} The court’s decision to include the transaction within the scope of Article 9 rendered an inequitable result inconsistent with the underlying policy goals of Article 9.\textsuperscript{284}

2. Merchant Deals in Goods of That Kind in a Name Other Than in the Name of the Person Making Delivery

Section 9-102(a)(20) requires that the merchant to whom the goods are delivered deal in goods of that kind under a name other than in the name of the consignor.\textsuperscript{285} To satisfy the requirement, the party must prove that (1) the merchant deals in goods of that kind delivered to it; and (2) the merchant deals in those goods under a name other than the deliverer.\textsuperscript{286} Both requirements must be satisfied to qualify as an Article 9 consignment.\textsuperscript{287} If the merchant either does not deal in goods of the kind delivered or deals in goods of that kind in the name of the consignor, its creditors should reasonably assume that the merchant lacks sufficient rights in the goods that it possesses.\textsuperscript{288} Either event places the merchant’s creditors on notice; thereby avoiding the problem of being misled by apparent ownership of goods held by the consignee.\textsuperscript{289}

a. Merchant Dealing in Goods of That Kind

One issue that has arisen is whether a merchant to whom raw materials are delivered “deals in goods of that kind” since the final product the merchant sells is different than the raw

\textsuperscript{282} Id. at *8.
\textsuperscript{286} Id.
\textsuperscript{288} Id.
\textsuperscript{289} Id.
materials delivered to it.\textsuperscript{290} When confronted with this issue, courts have found that the inclusion of goods into a final product was sufficient to establish that the merchant “deals in goods of that kind.”\textsuperscript{291} In \textit{In re Georgetown Steel Company}, the issue presented was whether the delivery of hot briquetted iron (“HBI”) to a merchant that planned to process it into steel satisfied the “deals in goods of that kind” requirement.\textsuperscript{292} The court found that the merchant satisfied the requirement noting that the HBI was typically considered part of the inventory of manufacturers like the consignee and that the HBI was an “integral component part of the [consignee’s] final product.”\textsuperscript{293}

\textit{b. Merchant Dealing in Goods Under a Name Other Than the Name of the Person Making Delivery}

The test for determining whether a merchant deals under a name other than the consignor is the same test courts applied when consignments were subject to former section 2-326.\textsuperscript{294} A party seeking protection under subsection 9-102(a)(20)(A)(i) must prove that the consignee was neither “completely enveloped”\textsuperscript{295} in, nor “completely identified”\textsuperscript{296} with, the consignor’s business “that potential creditors would necessarily assume that the business was that of the consignor solely.”\textsuperscript{297} In \textit{In re G.S. Distribution}, the bankruptcy court for the Southern District of New York noted the purpose of the subsection by stating:

This subsection [9-102(a)(20)(A)(i)] is designed to carry out one of the purposes of making consignments subject to Article 9, which is to ensure that a consignee’s general creditors are put on notice of the consignor’s interest in the consigned property, and to protect general creditors of the consignee from claims of consignors that have undisclosed consignment arrangements

\textsuperscript{291} \textit{Id.} at 358.
\textsuperscript{292} \textit{Id.} at 358–59.
\textsuperscript{293} \textit{Id.}
\textsuperscript{294} See \textit{supra} Part III.
\textsuperscript{295} \textit{Id.}
\textsuperscript{296} \textit{In re G.S. Distrib., Inc.}, 331 B.R. 552, 562 (Bankr. S.D.N.Y. 2005).
\textsuperscript{297} \textit{Id.}
with the consignee that create secret liens in the inventory."
Where a consignee operates only under the name of the consignor,
the U.C.C. assumes that the consignee’s general creditors will
be on notice of the consignment and will not be misled into be-
lieving that the merchant has ownership of the inventory in
its possession.298

In In re G.S. Distribution, the court found section 9-102
(a)(20)(A)(i) was not satisfied because the consignee was completely
enveloped in the consignor’s business because it “held itself out to
the public as a [consignor] store.”299 The consignee only sold the
goods of the consignor, and it only sold goods under the name of
the consignor.300 The court noted, however, that a consignee is not
completely enveloped in its consignor’s business if the consignee
sells goods of other suppliers in addition to those of the consignor or
if it is known that the consignee is a separate entity.301

Under former section 2-326, courts found that merchants
selling goods under the name of the consignor, while also selling
similar goods under their own name, were doing business under
a name other than the consignor.302 They reasoned that since
the consignee was selling similar goods under its own name, it
was not completely enveloped by the consignors’ names; there-
fore, the consignee’s creditors could have reasonably concluded
that consignee’s complete inventory of goods were owned by the
consignee.303 Most likely, courts applying section 9-102(a)(20)
will apply the same reasoning, since consignee’s ostensible own-
ership of consigned goods was the genesis underlying the UCC
adoption of consignment rules to protect consignee’s creditors
against undisclosed consignment arrangements.304

3. Not Generally Known by its Creditors to be Substantially
Engaged in Selling the Goods of Others

Section 9-102(a)(20)(A)(iii) provides that a transaction does
not qualify as an Article 9 consignment if it is generally known

299 Id. at 562 (alteration in original).
300 Id.
301 Id.
302 In re Wicaco Mach. Corp. 49 B.R. at 343.
303 Id.
by the consignee’s creditors that the consignee is substantially engaged in the business of selling goods of others.\footnote{Id.} The requirement was one of the former section 2-326(3) exceptions, but phraseology in Article 9 differs; former section 2-326(3)(b) was phrased in the affirmative, while section 9-102(a)(20)(A)(iii) is phrased in the negative.\footnote{Compare id. with U.C.C. § 2-326(3)(b) (1999) (AM. LAW INST. & UNIF. LAW COMM’N, amended 1999).} Under former section 2-326(3)(b), the consignor had to prove the consignee’s practices were generally known by its creditors,\footnote{See U.C.C. § 2-326(3) (1999) (AM. LAW INST. & UNIF. LAW COMM’N, amended 1999).} while section 9-102 (a)(20)(A)(iii) requires a party to prove that the consignee’s practices were not generally known.\footnote{See Id. § 9-102(a)(20)(A)(iii) (AM. LAW INST. & UNIF. LAW COMM’N 2017).} The negative framing of the phraseology supports the contention that the party seeking protection under section 9-102(a)(20) has the burden of proof, instead of placing the burden on the consignor, which is what former section 2-326(3) required.\footnote{Id. § 2-326(3).} To satisfy the “generally known” requirement a party must prove that (1) the consignee is substantially engaged in selling the goods of others, and (2) that the consignee’s practices are generally known by the creditors.\footnote{French Design Jewelry, Inc. v. Downey Creations, LLC (\textit{In re Downey Creations, LLC}), 414 B.R. 463, 471 (Bankr. S.D. Ind. 2009) (noting that even if actual knowledge by the consignee’s creditor was sufficient to satisfy the “generally known” test, the consignor had not proven that the consignee was substantially engaged in selling goods of others); \textit{In re Valley Media, Inc.}, 279 B.R. 105, 124–25 (Bankr. D. Del. 2003).} 


In interpreting section 9-102(a)(20)(A)(iii), courts continue to apply the standards adopted by those courts that dealt with the “generally known” requirement in former section 2-326.\footnote{In re Downey Creations, LLC, 414 B.R. at 472.} Like those earlier court opinions, courts applying section 9-102(a)(20) are split on whether a party can satisfy the “generally known” standard by merely proving that the competing creditor of the consignee has actual knowledge of the consignee’s practices.\footnote{In re Valley Media, Inc., 279 B.R. at 124.} Some courts have found the “generally known” standard requires a party
prove that a “majority” of creditors have actual knowledge of the consignee’s practices, while others have interpreted the standard to mean that only the competing creditor have actual knowledge of such practices.

Those courts requiring a “majority” continue to hold that a “majority” refers to the number of creditors, not the amount of the consignee’s creditors’ claims. But recent courts have included within the category of creditors “unsecured claims from utility companies and other third-party suppliers of goods and services that may not know exactly what kind of business is conducted on the [merchant’s] premises.” However, courts have stated that general knowledge regarding custom in the industry has not been sufficient to satisfy the “generally known” test.

Courts finding that the “generally known” standard is satisfied when the competing creditor has actual knowledge of the consignee’s practices have reasoned that a creditor with actual knowledge has no need of protection from secret liens because it was not misled by the consignee’s ostensible ownership of the consigned goods. In Fariba, the California Court of Appeals stated: “[S]ince the purpose of the notice exception is to ‘protect creditors from the “hidden” claim of the consignor, it should follow that a creditor of a consignee who has actual knowledge that the consignee is a consignee cannot claim the protection thereof.”

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314 In re Downey Creations, LLC, 414 B.R. at 471; In re Morgansen’s Ltd., 302 B.R. 784, 788 (Bankr. E.D.N.Y. 2003) (stating that “the personal knowledge of a few protesting consignors [as creditors of the consignee] does not satisfy their burden of proof of what subjectively the other creditors generally knew or should have known about the exact nature of the debtor’s business activities.”) (addition for clarification); Rayfield Inv. Co. v. Kreps, 35 So.3d 63, 65–66 (Fla. Dist. Ct. App. 2010) (rejecting the trial court’s reasoning that the consignor’s interest was superior to the perfected security interest of the consignee’s creditor since the creditor had knowledge that the goods in question were on consignment).


317 In re Morgansen’s Ltd., 302 B.R. at 788.

318 In re Downey Creations, LLC, 414 B.R. at 471 (citing In re Wedlo Holding, Inc., 248 B.R. 336, 341–42 (N.D. Ill. 2000)).

319 Fariba, 100 Cal. Rptr. 3d at 227–28.

320 Id. (quoting 3A LAWRENCE’S ANDERSON ON THE UNIFORM COMMERCIAL CODE (3d ed. 2009 supp.)).
In *Fariba*, the court echoed the sentiments articulated by the court in *Eurpac v. Republic*, in which the court concluded that it was nonsensical to give greater weight to imputed knowledge than actual knowledge. In *Fariba*, the court reasoned that if section 9-102(a)(20)(A)(iii) imputes knowledge to those creditors who could have reasonably obtained such knowledge, thereby holding them responsible as if they had actual knowledge, the standard should also be applied to hold responsible those creditors that have actual knowledge. The court concluded that “construing the knowledge exception to include constructive knowledge, but not actual knowledge, would lead to absurd results.” It concluded that its interpretation of the “generally known” standard was a reasonable, commonsense interpretation that was consistent with the apparent purpose of the legislature’s intent.

The Permanent Editorial Board in its recent proposed commentary explicitly rejects the position that the “generally known” standard is satisfied if a party only proves the competing creditor has knowledge of the consignee’s practices by highlighting the priority anomaly that would result if actual knowledge by a competing creditor satisfied the “generally known” standard. The Commentary states:

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.” 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 goods of others” and would be excluded from Article 9 as to creditors with that actual knowledge.

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321 Id. at 229.
322 Id.
323 Id.
324 Id. The court substantiated its holding by quoting to section 1-103 of the California Commercial Code that stated the Code “shall be liberally construed and applied to promote its underlying purposes and policies.” *Id. But see* Rayfield Inv. Co. v. Kreps, 35 So. 3d 63, 67 (Fla. Dist. Ct. App. 2010) (stating that “some legal rules explicitly allow their application to be varied by individual circumstances, using equitable principles, but the commercial law on secured transactions is not among them”).

325 PEB COMMENTARY DRAFT, *supra* note 9, at 4.
This anomalous result would open the door to circular priorities without promoting in any Article 9 policy.\textsuperscript{326}

The Permanent Editorial Board has proposed amending Official Comment 14 to section 9-102 to include the following:

Under clause (iii) of subparagraph (A), a transaction is not an Article 9 “consignment” if the consignee is “generally known

\textsuperscript{326} Id. at 4–5. The PEB provides the following discussion regarding circular priorities:

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).

\textit{Id.} at 5, n.27.
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 _______.327

The persistent uncertainty surrounding how to interpret the “generally known” provision suggests that its elimination from section 9-102(a)(20) should be considered. The necessity of the requirement is certainly questionable given the movement of commercial consignments to Revised Article 9.328 The decision to include commercial consignments within the scope of Article 9 brings with it the subtle, but significant, shift of placing on the consignor the burden of protecting its interests by providing notice to competing creditors.329 Neither the common law nor former Article 2 placed such an obligation on the consignor.330 And while it made sense under former Article 2 to include the “generally known” exception so consignors could avoid claims of creditors that were aware generally of consignee’s practices, the movement of consignments to Article 9 obviates the need to continue the tradition of the “generally known” exception. Now consignors have an affirmative duty to provide notice to protect their interests by simply filing a financing statement to avoid the problems of secret liens.331

The concept of notice is a capstone of Article 9.332 Under Article 9, the fact that a competing creditor has actual knowledge of a competing security interest does not undercut its own security interest.333 The relevant questions are whether its competitor provided notice, and if so, when was the notice provided.334 The perfection rules of Article 9 were devised to achieve notice, and notice serves a significant role in determining issues of priority.335 A filed financing statement is an efficacious and efficient means of achieving such notice.336 It provides constructive notice to all

327 Id. at 7.
328 WHITE & SUMMERS, COMMERCIAL LAW, supra note 109, § 22-4 at 1167.
330 Id. at 467, 470.
331 Id. at 470–71.
332 Id. at 470.
333 Id. at 472.
335 PEB COMMENTARY DRAFT, supra note 9, at 4–5.
336 In re Valley Media, Inc., 279 B.R. at 131.
In that regard, it is much more equitable to consignee’s creditors than the “generally known” requirement, which imputes knowledge to unknowing creditors if a majority of them have actual knowledge.\footnote{In re Downey Creations, LLC, 414 B.R. at 471.}

\textit{b. “Substantially Engaged” Requirement}\footnote{PEB COMMENTARY DRAFT, supra note 9, at 4.}

The “generally known” standard also requires that the party prove that the consignee’s creditors generally know that the consignee is \textit{substantially engaged} in selling goods of others.\footnote{In re Downey Creations, LLC, 414 B.R. at 472; In re Valley Media, Inc., 279 B.R. at 125.} However, the “substantially engaged standard” does not require a party to prove that the consignee’s creditors knew all the consignor’s identities or the specific items on consignment.\footnote{In re Downey Creations, LLC, 414 B.R. at 472 (noting that even if actual knowledge by the consignee’s creditor was sufficient to satisfy the “generally known” test, the consignor had not proven that the consignee was substantially engaged in selling goods of others); In re Valley Media, Inc., 279 B.R. at 125; Fariba v. Dealer Serv. Corp., 100 Cal. Rptr. 3d 219, 231 (Cal. Ct. App. 2009).} In \textit{Rayfield Investment}, the Florida Fourth District Court of Appeals noted that as a “general rule of thumb consignees are not considered ‘substantially engaged’ in selling the goods of others unless they hold at least [twenty percent] of inventory on a consignment basis.”\footnote{Rayfield Inv. Co. v. Kreps, 35 So. 3d 63, 66 (Fla. Dist. Ct. App. 2010).}

\textit{4. Exclusion of Consumer Goods from Article 9 Consignments}

Section 9-102(a)(20)(C) excludes from Article 9 consignments any goods that were consumers goods immediately before delivery to a merchant.\footnote{U.C.C. § 9-102(a)(20)(C) (AM. LAW INST. & UNIF. LAW COMM’N 2017); see In re Music Center RV, LLC, 304 S.W.3d 806, 809 (Tenn. 2010); Mackela v. Bentley, 614 S.E.2d 648, 650–51 (S.C. Ct. App. 2005) (rejecting secured party’s claim to consigned goods concluding that the consignment transaction was not governed by Article 9 because the goods were consumer goods immediately before delivery to the consignee).} In \textit{In re Haley & Steele}, the Superior Court of Massachusetts found that consigned goods “consist[ing]
of artwork that was used or bought for use primarily for personal, family, or household purposes immediately before delivery to Haley and Steele ... falls outside of the ‘consignment’ defined in [section] 9-102(a)(20).”344 In In re Haley & Steele, the court articulated the policy underlying the exclusion of consumer goods by stating that: “[A] typical consumer ... should not be required to comply with the complexities of secured lending under Article 9 of the Uniform Commercial Code in order to have protection from [a consignee’s] creditors.”345

In In re Haley & Steele, the court rejected the application of revised section 2-326 to consumer consignments noting that the Article 2 provision would subject consumer consigned goods to claims of competing creditors, which it viewed as contrary to the Article 9 reasoning for excluding them from the statutory definition of Article 9 consignments.346 Respected commentators James J. White and Robert S. Summers have posited that the rights of creditors whose debtors have consignment arrangements with consumer consignors “will have to be determined by looking at the common law of the particular states.”347

5. Exclusion of Consignments That Create Security Interest-
Securing Obligations from Article 9 Consignments

Section 9-102(a)(20)(D) excludes from the definition of Article 9 consignments those consignments that create security interests “that secure an obligation.”348 By the exclusion, “[t]he drafters here have preserved a distinction between a conventional commercial consignment defined in 9-102(a)(20), which in almost all cases, is a ‘security interest,’ and the unusual commercial consignment which creates a security interest ‘that secures an

345 Id.
346 Id. at *4 (quoting to the position of James J. White and Robert S. Summers in 4 Uniform Commercial Code at 38 (5th ed.) that “[i]t is unlikely that the drafters wished to leave the consumer consignor worse off than a commercial consignor, yet that would be the outcome if consumer consignments (now excluded from Article 9) are governed by 2-326”).
347 WHITE & SUMMERS, COMMERCIAL LAW, supra note 109, § 22-4 at 1167.
obligation.”349 However, both transactions are governed by the perfection and priority rules of Article 9, but the default rules of Part 6 of the UCC Article 9 handle the two differently.350

The exclusion of consignments intended as a security, “that secure obligations” from section 9-102(a)(20), is consistent with how such transactions were treated by the courts under former section 2-326.351 The major distinction is that Revised Article 9 explicitly provides that such transactions are excluded from the definition of an Article 9 consignment,352 while former section 2-326 did not.353 Post revision, courts continue however to apply the tests developed by courts that dealt with the issue under section 2-326,354 For example, the court in In re Georgetown Steel Company found that “[w]hether an interest ‘secures an obligation’ has been described as dependent upon whether there is a duty [of the consignee] to pay for unsold goods.”355

C. Which Party Has the Burden of Proof Under Section 9-102(a)(20)?

Another issue on which courts are split is which party has the burden of proof under section 9-102(a)(20). Several courts have found that the burden of proof is on the party seeking protection under section 9-102(a)(20).356 In In re Morgansen’s Ltd., the bankruptcy court for the Eastern District of New York stated that the burden of proof is on the party seeking protection under the statutory definition, but then proceeded to place the burden on the consignors who were arguing that section 9-102(a)(20) did

349 WHITE & SUMMERS, COMMERCIAL LAW, supra note 109, § 22-4 at 1167.

350 Section 9-601 provides that “this part imposes no duties upon a secured party that is a consignor,” therefore, the consignor does not have to comply with the collection, disposition, and enforcement provisions of Part 6 of Article 9, U.C.C. § 9-601(g) (AM. LAW INST. & UNIF. LAW COMM’N 2017); see WHITE & SUMMERS, COMMERCIAL LAW, supra note 109, § 22-4 at 1167.

351 See supra Part III for a discussion on Former UCC Article 2 treatment of consignments.

352 See WHITE & SUMMERS, COMMERCIAL LAW, supra note 109, § 22-4 at 1167.

353 See id.


355 Id.

not apply.357 Like In re Morgansen’s, Ltd, the bankruptcy court in In re G.S. Distribution stated that the burden is on the person seeking protection under section 9-102(a)(2), but unlike the Morgansen’s opinion, the court consistent with its statement, placed the burden on the debtor asserting that 9-102(a)(20) applied.358 In In re Salander-O’Reilly Galleries LLC, the bankruptcy court noted that “in the Second Circuit, the burden of proof falls on the party claiming applicability of [section] 9-102(a)(20) to show that each element of the definition is satisfied.”359

Other courts have established, however, a firm rule that the burden of proof is on the consignor.360 In In re Downey Creations, LLC, the bankruptcy court for the Southern District of Indiana rejected the plaintiff’s argument that the burden should be on the party seeking protection under the statutory definition.361 The court found that the burden should be placed on the party bearing the risk under section 9-102(a)(20), which it identified as the consignor.362 It reasoned that “[a]s between a consignee’s creditors and the consignor, only the consignor is in a position to determine whether its transaction” satisfies the statutory definition of an Article 9 consignment, and if it determines that its transaction satisfies the definition, the consignor must “file a financing statement to perfect its interest” in the consigned good.363 The court stated that if the consignor does not file a financing statement, it should “bear the burden of proving that the transaction”

358 In re G.S. Distrib., Inc., 331 B.R. at 561.
361 In re Downey Creations, LLC, 414 B.R. at 469 (placing the burden of proof on the consignor to prove that it is generally known by debtor’s creditors that it was substantially engaged in the business of selling goods of others); TSA Stores Inc. v. M J Soffe, LLC (In re TSAWD Holdings, Inc.), 565 B.R. 292, 299 (Bankr. D. Del. 2017) (finding that the consignor must prove by a preponderance of the evidence that the consignment is not governed by Article 9).
362 In re Downey Creations, LLC, 414 B.R. at 469.
363 Id. at 470.
does not satisfy the statutory definition. It posited that placing the burden on the consignor creates an incentive for it to file a financing statement, which consequentially “not only discourages ‘secret liens’, but also provides more predictability, thereby reducing the need for costly litigation.”

The court in In re Downey Creations, LLC also reasoned that the burden should be on the consignor since former section 2-326 explicitly placed the burden on the consignor to prove that one of the exceptions in section 2-326 (3) was applicable. Even though the court acknowledged that “[s]ection 9-102(a)(20) does not explicitly assign the burden of proof as former section 2-326 did,” it highlighted that “the purpose behind the provision [section 9-102(a)(20)] suggests to the Court that the burden nevertheless remains on the consignor.”

The court’s reliance on former section 2-326 was misplaced. Former section 2-326(3) explicitly provided that the consignor had to prove that one of the former section 2-326(3) exceptions applied to avoid the claims of a consignee’s creditors. And each exception was framed in the affirmative—the consignor had to prove it complied with an applicable sign law; the consignor had to prove that consignee’s creditors were generally aware of the consignee’s practices; the consignor had to prove it complied with section 9-114. In contrast, Article 9 is silent on who bears the burden of proof. And the majority of the elements of section 9-102(a)(20) are framed in the negative requiring a party to prove that the merchant “is not an auctioneer;” that the good was “not a consumer good immediately before delivery;” and that “the transaction does not create a security interest that secures an obligation.” In addition, a party must prove that “is not generally known by its creditors to be substantially engaged in selling the goods of others,”

364 Id.
365 Id. at 471.
366 Id. at 469.
367 Id.
369 Id.
which specifically contrasts with the language of former section 2-326, which required the consignor to prove in the affirmative that it was “generally known by its creditors to be substantially engaged in selling the goods of others.”

If a consignor literally proves the negative with respect to each of the above-mentioned section 9-102(a)(20) elements, the consignment transaction would be included, not excluded from Article 9 coverage; thereby subjecting the consigned goods to a creditors’ claims absent a financing statement filing by the consignor. In many instances, the consignor’s intent is to avoid coverage under Article 9. Rather than establishing a firm rule that places the burden on the consignor, a more sensical approach is to place the burden of proof on the party seeking protection under the statute. Typically, judicial lien creditors and secured creditors will be the parties seeking protection under 9-102(a)(20). Placing the burden of proof on the party seeking protection follows both the letter and the spirit of the statute by assigning the burden to whichever party will benefit from its application.

D. What Law Governs Non–Article 9 Consignments

Another issue that courts have confronted is what law governs non–Article 9 consignments. Most courts have found that such consignments are governed by the common law of bailment unless state law other than Article 9 applies. A few courts have posited, however, that those consignments not qualifying as Article 9 consignments are subject to the “sale or return” provision of revised section 2-326. These courts have taken this position

374 See generally id. §§ 9-102(a)(19)–(21), 9-114.
375 In re Haley & Steele, Inc., No. 051617BLS, 2005 WL 3489869, at *4 (Mass. Super. Ct. Nov. 14, 2005) (concluding that since consumer consignments were not governed by the UCC after the 1999 revisions, they were once subject to the common law, which the court concluded was “essentially the law of bailments”).
376 In re Valley Media, Inc., 279 B.R. 105, 123 (Bankr. D. Del. 2002) (stating that “[o]nce it is determined that either former U.C.C. § 2-326(3) or revised U.C.C. §§ 9-102(a) (20) & 9-319(a) applies, the goods are deemed to be on sale or return with respect to claims made by the creditors of the consignee”); Georgetown Steel Co. v. Progress Rail Servs. Corp. (In re Georgetown Steel Co.), 318 B.R. 352, 357 (Bankr. D.S.C. 2004) (noting that if a consignment does not satisfy
even though the Official Comment 4 to revised section 2-326 states “[c]ertain 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.”

And while most courts have followed the position expressed in the Official Comment, the few court opinions that have rejected it have created some confusion concerning this issue.

1. Consignment v. “Sale or Return” Transaction

In part, the confusion likely centers on the outward similarities between consignments and “sale or return” transactions. Both transactions involve the delivery of goods to a merchant, which can return the goods to the owner if they are not sold. However, the economic realities of the two transactions differ in ways that render them mutually exclusive. “Sale or return” transactions involve the delivery of goods to a merchant that purchases them for the purpose of reselling them to its customers. The “sale or return” provision under section 2-326 indicates that the goods are delivered to a buyer, and section 1-103 defines a buyer as a “person who buys or contracts to buy goods.” Even though the buyer “retains the right to return the goods, a completed sale is generally deemed to have taken place.” The merchant becomes the owner to whom title is transferred, despite its right to return the goods if they are not sold. In contrast, consignment transactions involve a type of bailment for the purpose

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the Article 9 definition of a consignment “it is likely governed by Article 2”); In re Morgansen’s Ltd., 302 B.R. 784, 788–89 (Bankr. E.D.N.Y. 2003).


378 See PEB COMMENTARY DRAFT, supra note 9, at 3 n.19.


384 Id.

of sale in which the goods are entrusted to the consignee for sale without transference of title and ownership. In the former, the buyer becomes the owner of the good, while in the latter the consignor is merely an agent selling the goods on behalf of its principal, the consignor.

One area in which the issue has arisen is with consumer consignments, since they are explicitly excluded from Article 9 coverage. Courts have found that such transactions are not “sale or returns” emphasizing that the delivery of such goods neither involves a purchase nor a transference of title to the merchant. Courts have noted that subjecting such consignments to claims of consignee’s creditors would be contrary to reason for which they were excluded from the statutory definition of Article 9 consignments, thereby circumventing the drafters’ intent to protect consumers, an intention evidenced by the exclusion of consumer consignments from the definition of Article 9 consignments.

In Haley & Steele, the court found that a consignment transaction in which artwork was delivered by consumers to a consignee was statutorily excluded from the definition of an Article 9 consignment. The court found that the Revised section 2-326 did not apply to consumer consignments because that section contemplated a sale with title passing to the consignee, an event which did not occur when the consumers delivered their artwork to the consignee. The court reasoned that analyzing the consumer consignment under 2-326 would subject the consigned goods to the claims of the consignee’s creditor, a result that would place “the consumer consignor worse off than a commercial consignor.”

386 PEB COMMENTARY DRAFT, supra note 9, at 3–4.
388 PEB COMMENTARY DRAFT, supra note 9, at 3–4.
390 Id.
391 Id.
392 Id. at 4.
393 Id.
394 Id.
In *Music City*, the bankruptcy court for the Middle District of Tennessee presented with the question of whether a consumer consignment should be analyzed under UCC Article 2-326, certified the question to the Supreme Court of Tennessee on how to handle “orphaned” consignments. The Tennessee Supreme Court noted that the language of section 2-326 referred to a “buyer” and that Music City, the consignee, did not contract to buy the goods as the term “buyer” is defined by section 2-103(1), which defines a buyer as one contracted to buy goods. The court concluded that section 2-326 did not apply because the consignee did not contract to buy the consigned goods, “but rather, as a consignee, [it] agreed to take possession and to try to sell them to a third party for a commission.”

While most courts have found that “sale or return” transactions and consignments are mutually exclusive, a few courts continue to posit that consignments not qualifying as Article 9 consignments are “sale or return” transactions subject to Revised section 2-326. In *Morgansen’s Ltd.*, a bankruptcy court found that a consignment transaction that did not qualify as an Article 9 consignment should be subject to analysis under Revised section 2-326. The Permanent Editorial Board in its proposed draft

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397 *In re Music City RV, LLC*, 304 S.W.3d 806, 812 (Tenn. 2010). The Tennessee Supreme Court agreed with the bankruptcy court that the consumer consignment was not a UCC Article 9 consignment because section 9-102(a)(20)(a)(C) excludes goods that are “consumer goods immediately before delivery.” *Id.* at 809–10.

398 *Id.* at 811.

399 *In re Valley Media, Inc.*, 279 B.R. 105, 123 (Bankr. D. Del. 2002) (stating that “[o]nce it is determined that either former U.C.C. § 2-326 or revised U.C.C. §§ 9-102(a)(20) & 9-319(a) applies, the good are deemed to be on sale or return with respect to claims made by creditors of the consignee”); *Georgetown Steel Co. v. Progress Rail Servs. Corp. (In re Georgetown Steel Co.),* 318 B.R. 352, 357 (Bankr. D.S.C. 2004) (noting that if a consignment does not satisfy the Article 9 definition of a consignment “it is likely governed by Article 2.”); *In re Morgansen’s Ltd.*, 302 B.R. 784, 788–89 (Bankr. E.D.N.Y. 2003).

400 *In re Morgansen’s Ltd.*, 302 B.R. at 789. The consignor appealed the bankruptcy court ruling, and on appeal, the federal district court for the Eastern District of New York remanded the case for clarification from the bankruptcy court concerning its use of the term “buyer for resale,” emphasizing that, “there is no evidence that title passed from Goss to Morgansen’s with respect to any of
explicitly rejects the court’s position in *Morgansen’s Ltd.* A footnote to the PEB Commentary draft indicates that the bankruptcy court for the Eastern District of New York in the *In re Morgansen’s Ltd.* case erred in finding that consignment transactions that did not satisfy the Article 9-102(a)(20) statutory definition should be subject to analysis under the UCC Article 2 sale or return provision. The PEB Commentary references *In re Morgansen’s Ltd.* by stating, “[r]ather than applying the common law, the court erroneously turned to [s]ection 2-326 and concluded that ‘the goods consigned to the debtor clearly were delivered on a “sale or return” basis.’”

The PEB Commentary Draft states that consignments and “sale or return” transactions are mutually exclusive and provides the following distinction concerning the two types of transactions:

A consignment is a bailment, and the consignor remains 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. 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. A sale or return is not a consignment; a consignment is not a sale or return.

And the Permanent Editorial Board proposes that the following amendment to Official Comment 4 to section 2-326:

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.

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401 See PEB COMMENTARY DRAFT, supra note 9, at 2–3.
402 Id. at 3 n.19.
403 Id. at 4 n.19.
404 Id. at 3–4.
405 Id. at 6.
2. Distinguishing Consignments from “Sale or Return” Transactions

Courts have identified certain traditional indicia to distinguish consignments from “sale or return” transactions. One distinguishing factor in determining whether a transaction is a sale or return or a consignment is the form of compensation received by the purchaser for subsequent sale of the good. One question is whether the merchant is compensated by commission or compensated by the difference between the price charged by the seller and the price set by the merchant in its resale of the goods. In a sale or return, the merchant receives a profit as its form of compensation, which is the difference between the cost the merchant pays the seller and the price at which it resells the goods to a third party. In contrast, in a consignment transaction, the purchaser is compensated by commission. In consignment transactions, the consignor establishes the price at which the consigned goods should be sold by the consignor. In United States v. Nektalov, the federal district court for the Southern District of New York quoting Gem Diamond Company of New York v. Klein, stated: “[A] ‘true consignment’ is characterized by the fact that the consignor retains ownership and sets the sale price; the consignee receives a commission and not the profits of the sale.”

Other traditional indicia of consignments include an accompanying selling list with the consignment agreement that references the prices dictated by the consignor instructing the consignee concerning the amount it must charge third parties

408 See Nektalov, 440 F. Supp. 2d at 299; Italian Designer Imp. Outlet, Inc., 891 N.Y.S.2d at 266.
409 See Nektalov, 440 F. Supp. 2d at 299; Italian Designer Imp. Outlet, Inc., 891 N.Y.S.2d at 266.
410 See Nektalov, 440 F. Supp. 2d at 299; Italian Designer Imp. Outlet, Inc., 891 N.Y.S.2d at 266.
411 Nektalov, 440 F. Supp. 2d at 299.
412 Id. at 299 (quoting Diamond Gem Co. of N.Y. v. Klein, No. 92 Civ. 2503, 1995 WL 72382, at *3 (S.D.N.Y. Feb. 21, 1995)).
for the consigned goods. Also, custom will play a significant role in determining whether a transaction is a sale or return or consignment. In some commercial relationships, consignments are the prevalent form of business arrangements between parties. Also instructive is whether the buyer bears the risk of loss once the good is in its possession. Transactions are more likely considered sale or returns if the buyer is responsible for maintenance and is required to insure against theft or damage.

Nektalov is instructive because the court identifies several attributes that render a transaction a sale, rather than a consignment. In that case, diamond owners argued that their delivery of diamonds to a diamond dealership contained the “traditional hallmarks of a consignment.” The court identified the following facts as persuading it to conclude that the transaction was a sale, not a consignment: (1) the time of possession; (2) the means of compensation; (3) the willingness of the owner to receive something of equal value back from the consignor, even when the delivered item was not sold; (4) the absence of a written consignment agreement; and (5) the price schedule.

The court highlighted one of the diamond owner’s testimony in which he stated that he “left it up to Roman Jewelers [the merchant] to maximize the profit on the diamonds.” The other diamond owner admitted that he had never allowed a merchant to retain possession of his diamonds for more than a year, but in this case, the diamonds had been in the possession of the merchant for a much longer period. Even though he testified that the arrangement was a consignment, he “did not produce any written consignment.”

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413 Italian Designer Imp. Outlet, Inc., 891 N.Y.S.2d at 267.
414 Id. But see Nektalov, 440 F. Supp. 2d at 299 (acknowledging that consignments are frequently utilized in the diamond business, but indicating that “such a fact, in and of itself, does not dictate a finding that all diamond transactions, including the instant transactions, are consignments per se”).
415 Italian Designer Imp. Outlet, Inc., 891 N.Y.S.2d at 266.
416 Id. at 267.
417 Id.
419 Id. at 301.
420 See id. at 301–02.
421 Id. at 301.
422 Id. at 302.
423 Id.
was one diamond owner’s testimony that he would have accepted, in fact, “would have been entirely satisfied,” had the merchant to which he delivered the diamonds, delivered to him in return different diamonds provided they had the same value as the ones he delivered initially to the merchant.\footnote{Id.} The court noted that the owner’s willingness to accept different diamonds than those initially delivered “cut against a consignment relationship, in which the agent-consignee solely possesses the goods, and the principal-consignor retains a right to repossess the same exact goods prior to their sale to a third party.”\footnote{Id. at 302.}

CONCLUSION

The Article 9 legal framework for consignments treats in a much more comprehensive manner the rights of consignors vis-à-vis competing creditors than did former Article 2; however, the advent of the new framework has engendered new areas of uncertainties and perpetuated certain issues that were persistent under former section 2-326.\footnote{See generally PEB COMMENTARY DRAFT, supra note 9 (speaking to issues that were resolved by the new framework, but also highlighting current problematic places for courts).} The Permanent Editorial Board proposed commentary and amendments to the UCC address some, but not all, of the issues of uncertainty surrounding the law of consignments.\footnote{See generally id.} A complete revision of section 9-102(a)(20) should be considered that would include moving consignments from the general definitional provision of Article 9 to its own separate provision, similar to the movement of leases from former section 1-201(b)(37) to revised section 1-203. Perhaps, the consignment provision should be moved to its own separate provision within Article 9 to include provisions to resolve the persistent uncertainties surrounding consignment law.

Separate treatment of consignment law in its own revised provision may be necessary to provide greater clarity and certainty to consignment transactions. The revision could include provisions that resolve the uncertainties discussed throughout this Article. The “purpose for sale” issue concerning whether a
sale by a merchant back to the owner is a consignment could be
resolved by including a provision that states, “A consignment means
a transaction, regardless of its form, in which a person delivers
goods to a merchant for the purpose of sale to a third party.” To
resolve the “purpose of sale” issue regarding the delivery of raw
materials, the revision could include a provision that states that
states, “Consigned goods include any finished product generated
from raw materials delivered to a merchant for manufacturing,
processing, commingling, or the like for the purpose of sale to a
third party.” And the revision could include a provision that resolves
the burden of proof issue by providing that, “The party contending
the applicability of section 9-102(a)(20) has the burden of estab-
lishing that each element of that section has been satisfied.”

In addition, instead of amending the Official Comments to
address the “sale or return” versus consignment distinction, per-
haps the revision could include a provision that states “Those
consignments that do not qualify as Article 9 consignments under
section 9-102(a)(20) are not governed by revised section 2-326 as
“sale or return” transactions. Law other than Articles 2 and 9 of
the UCC applies to such transactions.” Moreover, instead of amend-
ing the Official Comments to address issues involving the “gen-
erally known” requirement, perhaps the requirement should be
eliminated since Article 9 imposes an affirmative duty on the
consignor to give notice by filing a financing statement.

A separate provision for consignments that provides com-
prehensive resolution of the vexing issues identified throughout
this Article would bring much-needed clarity, uniformity, and cer-
tainty to consignments. And resolving these issues is best achieved
by devising consignment rules consistent with the underlying
principles and policies of Article 9 to ensure predictable and ef-
ficient outcomes.