True Consignment under the Uniform Commercial Code, and Related Peccadilloes, The

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THE "TRUE" CONSIGNMENT UNDER THE UNIFORM COMMERCIAL CODE, AND RELATED PECCADILLOES

by

Peter Winship*

Professor Gilmore: As Article 9 reads, we leave it more or less to the courts to determine whether a particular consignment was not backed by security interest or was. We don't cover all consignments, necessarily.

Mr. Ireton: I mean, the true consignment was intended to be covered by Article 9.

Professor Gilmore: I am not sure what you have in mind by 'a true consignment.'

Marketing patterns change: the independent, small-town horse trader becomes the new-car dealer with a franchise from a national automobile manufacturer. Populations grow, technology develops, communications improve, consumer demands shift, banking facilities spread, and credit financing policies change. Legal rules may also influence marketing patterns as lawyers are accepted as business advisers and communicate to businessmen the legal rules regulating directly or indirectly the marketing of goods.

Distributing goods through commission agents, for example, is no longer as important a marketing device as it was one hundred years ago. Along the western frontier and in the agricultural south the commission agent or factor was an essential middleman in the distribution and exchange of agricultural and manufactured produce. Producers consigned goods to the agent who

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1. Hearing Before Enlarged Editorial Board, January 27-29, 1951, 6 BUS. LAW. 164, 193 (1951). The Board's discussion of consignments under article 2 appears in id. at 192-94. It should be read with the caution that the text of UNIFORM COMMERCIAL CODE § 2-326 (1951 version) was later amended. See note 29 infra. The hearing clearly indicates that the draftsmen themselves were not in full agreement on the definition of the "true" consignment. In the course of discussion the following definitions were suggested. Ireton: "[A true consignment is a] regular consignment contract where it is purely an agency arrangement, not intended as security, although in its economic incidence it is a security." Kripke: "The Reporters have been consistent in saying that if someone agrees to buy some goods, until he pays that is on consignment... If there is no obligation to pay, it is a true consignment and not under Article 9, and falls under only 326." Braucher: "Under the present law sometimes you have a disguised security transaction going under the name of consignment. That would be covered under Article 9. In other cases you have a regular agency arrangement which 2-326 as it now stands would invalidate unless there were a sign law, or you complied with this general knowledge provision which I don't thoroughly understand. For those transactions—the true agency case—I wanted to provide a procedure for validation." Hearing, supra, at 193.


3. The importance of the commission agent for the nineteenth century economy is eloquently expressed by a Texas court in Mills v. Johnston, 23 Tex. 309 (1850):

The commission business is the creature of agriculture and commerce, and has grown up in all the great centers of trade throughout the United States. The commission merchant finds his proper and necessary place
would sell this produce and remit the sale price to the producers less a commission. Both common law rules and remedial legislation favored the consignment arrangement: the factor had a common law lien on the principal's goods while in his possession to secure advances made to the principal; legislation protected the third party who purchased in good faith from the factor. One hundred years later the consignment transaction, while still important, is no longer as common. The frontier has passed, transportation has improved, communications are speedier, population centers have grown in size. Legal rules have no doubt had an impact on the business of the commission agent. The most obvious example of this impact is the growth of the large, mobile corporation as a combination of men and capital which could purchase and market through its own employees. Less dramatically, the changes in private commercial law and the introduction of antitrust and bankruptcy legislation have influenced consignment marketing.

In the area of private commercial law the key concepts in the consignment transaction were simple. The owner or title-holder of the goods gave possession of the goods to an agent or bailee for sale, who would sell the goods to third persons and remit the proceeds to the owner-principal less the agreed-upon commission. On the sale to the third party, title passed directly from the owner-principal to the third party. "Agency" rules governed the authority of the agent and the rights and obligations of both principal and agent. Location of "title" resolved disputes over such matters as risk of loss and the rights of the agent's creditors. True, the purity of the consignment device was contaminated sometimes by the use of the consignment as a disguised conditional sale to avoid the public filing required by conditional sales laws. But if you kept in mind the "true" basic concepts you could solve most problems.

Twentieth-century scholarly disillusion with the concept of title in commercial law is well known. As a leading proponent of "realism" in commercial law Karl Llewellyn first attacked "title" in the law journals and then, as

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4. For a review of the common law lien and the early Factors Acts see S. Williston, The Law Governing Sales of Goods §§ 317-23 (1st ed. 1909). The second (1924) and revised (1948) editions of this standard work are less comprehensive with respect to the historical material. For a mid-nineteenth century summary of the law by another eminent authority, see W. Story, A Treatise on the Law of Sales of Personal Property 74-92 (2d ed. 1853).

5. Rio Grande Oil Co. v. Miller Rubber Co., 31 Ariz. 84, 250 P. 564, 565 (1926), is often quoted: "[A] consignment of goods for sale does not pass title at any time, nor does it contemplate that it should be passed. The very term implies an agency, and the title is in consignor, the consignee being his agent." F. Tiffany, Law of Sales 11 n.54 (2d ed. rev. 1906) suggests one exception to the above analysis: "Where goods are consigned on such terms that the consignee is at liberty to sell on such terms as he sees fit, but must in such case pay the consignor at fixed prices, until a sale is made the property remains in the consignor, but when he sells the property passes to him, and he sells on his own account, and not as agent."

6. See Llewellyn, Through Title to Contract and a Bit Beyond, 15 N.Y.U.L.Q. 159
Chief Reporter in the preparation of the Uniform Commercial Code, drafted provisions which replaced title as a general concept with more specific rules allocating risks at different steps in the course of a commercial transaction. Not only sales law but also the law of secured commercial transactions came under the influence of this skepticism about "lump" concepts.7

Under the circumstances, marketing by consignment could hardly avoid the influence of Code thinking. Functionally, the consignment is in many cases very similar to the "sale or return" or to inventory financing. As one court, writing in 1939, pointed out: "It is not readily apparent why any consignment arrangement is not a secret lien against creditors of a shaky consignee, as harmful as an unfiled chattel mortgage or conditional sale."8

The Code draftsmen, therefore, provided for the consignment at various places in the Code. Commentators and courts have struggled with these provisions and the Code draftsmen themselves have amended and supplemented them in the subsequent official texts of the UCC. Confusion remains, however, especially with respect to the relation of article 2 (sales) provisions to those in article 9 (secured transactions). Nor is the question of academic interest only. The interpretation of one commentator led another to deplore the academic hostility to the consignment as a flexible marketing device.9

In this Article I focus on the Uniform Commercial Code rules regulating consignments. I first set out the legislative history of these rules—an instructive story in itself—and place them in the context of the related rules governing the "sale on approval" and the "sale or return." I then comment on the consignment rules themselves, with emphasis on the relation of article 2 provisions to those in article 9. I do not discuss recent antitrust developments, which have had a considerable impact on marketing by consignment, as others have commented on these developments.10

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7. The genesis and jurisprudence of the Uniform Commercial Code, with special emphasis on the role of Llewellyn, are well-analyzed in W. Twining, Karl Llewellyn and the Realist Movement 270-340 (1973).

8. Liebowitz v. Voiello, 107 F.2d 914, 916 (2d Cir. 1939). The court goes on to state:

We do not see how the behavior of the parties could have been very different had the arrangement been one of outright or conditional sale. It is neither easy nor practical to say where a consignment ends and a sale begins. In the light of the Ludvigh case [Ludvigh v. American Woolen Co., 231 U.S. 522 (1913)], however, there is a line to be drawn. When the rights and duties created by the contract (as actually performed) are substantially the same as the rights and duties that would be created by a sale, the arrangement must be deemed a sale. The asserted intent of the parties that there be a consignment and not a sale cannot prevail when, as here, the rights of creditors intervene.

Id. at 916-17.


10. See Duesenberg, Consignment Distribution Under the Uniform Commercial Code: Code, Bankruptcy and Antitrust Considerations, 2 Valparaiso U.L. Rev. 227, 243-53 (1967). The older antitrust cases distinguished the "true" from the "false" consignment, permitting consignor in a true agency consignment to fix the prices of "his"
I. CONSIGNMENTS IN CONTEXT

A. Legislative History

The evolution of the Code texts referring to consignments illustrates not only the draftsmen's ambivalence to consignments but also the process by which the Code grew by accretion as it went through layer on layer of advisory and legislative committees. The legislative history also explains some anomalies noted by courts, although how much weight a given court will place on this form of explanation when interpreting the promulgated text is problematical.\(^\text{11}\)

As an agency arrangement, the consignment was outside the scope of the Uniform Sales Act of 1906 and the Act made no reference to the consignment transaction. The Act did, however, set out rules of interpretation for the sale or return and sale on approval\(^\text{12}\) which the Act borrowed with


\(\text{Here we have an antitrust policy expressed in Acts of Congress. Accordingly, a consignment, no matter how lawful it might be as a matter of private contract law, must give way before the federal antitrust policy. . . . When . . . a 'consignment' device is used to cover a vast gasoline distribution system, fixing prices through many retail outlets, the antitrust laws prevent calling the 'consignment' an agency, for then the end result . . . would be avoided merely by clever manipulation of words, not by differences in substance. The present, coercive 'consignment' device, if successful against challenge under the antitrust laws, furnishes a wooden formula for administering prices on a vast scale.}

377 U.S. at 18, 21-22. Relying on the Simpson decision, the federal district court in the recent \textit{General Electric} case held that the consignment arrangement upheld in the 1926 decision had been overruled by Simpson. 358 F. Supp. at 738. Comments on these cases have proliferated. \textit{See, e.g., Rahl, Control of an Agent's Prices: The Simpson Case—A Study in Antitrust Analysis, 61 NW. U.L. REV. 1 (1966).}

11. \textit{UNIFORM COMMERCIAL CODE § 1-102(3)(g) (1952 version) stated: "Prior drafts of text and comments may not be used to ascertain legislative intent." The 1957 official text omitted this provision. The reader should note the comment in R. SPEIDEL, R. SUMMERS & J. WHITE, TEACHING MATERIALS ON COMMERCIAL AND CONSUMER LAW 44 (2d ed. 1974):}

\(\text{It will have to be left to the Supreme Court of the United States to rule out the use of prior versions of sections and comments as an unconstitutional form of cruel and inhuman punishment of fellow lawyers. Or perhaps the decisive argument will be that because of their scarcity (only a few libraries have them) their use denies equal protection of the laws.}

12. \textit{UNIFORM SALES ACT § 19, rule 3 (1906 version) stated:}

\textit{Rules for Ascertaining Intention.} Unless a different intention appears, the following are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer. . . .

\textit{Rule 3. (1) When goods are delivered to the buyer 'on sale or return,' or on other terms indicating an intention to make a present sale, but to give the buyer an option to return the goods instead of paying the price, the property passes to the buyer on delivery, but he may revest the property in the seller by returning or tendering the goods within the time fixed in the contract, or, if no time has been fixed, within a reasonable time. (2) When goods are delivered to the buyer on approval or on trial or on satisfaction, or other similar terms, the property therein passes to the buyer—}

(a) When he signifies his approval or acceptance to the seller or does
amendments from the British Sale of Goods Act, 1893. Section 19, rule 3
distinguished between these two special sales transactions by reference to the
passage of title. In a sale or return title passed immediately as in an ordinary
sale, but the buyer had the option to return the goods instead of paying the
price; whereas in a sale on approval title passed only when the buyer
accepted the goods after trial. Who had title determined such problems as
who bore the risk of loss as spelled out elsewhere in the Act.

When revision of the Uniform Sales Act began the draftsmen not only
suggested redrafting in functional terms the rules of interpretation for the
sale or return and the sale on approval but also the need to clarify the
"whole 'memorandum' situation, including the 'consignment' and 'conditional
sale for resale' phases." The first published Report and Second Draft of
the Revised Uniform Sales Act commented:

This subsection [section 19, rule 3] was peculiar, in the Act of 1906, in
giving no indication on what facts operated to produce one or the other
result, although the rest of this section is devoted to that end. The added
clauses serve this need, in accordance with practice. But no clause
has been added to help distinguish a 'sale or return' from a 'consign-
ment.' In regard to that, a presumption in favor of 'sale or return'
needs adding. Both the memorandum and the bookkeeping entries are
commonly—and often intentionally—ambiguous; risk rests properly
(and often expressly) on the buyer-or-consignee in possession; ac-
counting or return within a fixed time, at a fixed price, is a normal re-
quirement, either way; but consignment is not to be favored, as
against the trustee in bankruptcy of a buyer-or-consignee; the older
use of consignment to maintain prices is no longer necessary; and the
inconvenience of cutting off essential warranties to consumers if the
goods pass through a chain of 'sales,' is avoided by Section 16-B.

The text of a provision on consignments was first published in the
Proposed Final Draft No. 1 (April 27, 1944). Although the specific
wording was revised, this draft text established the basic pattern of the
present official text: (a) if the person receiving the goods to be sold meets
certain criteria, (b) the goods in his possession will be subject to the claims
of his creditors (c) notwithstanding a purported reservation of title (d)
unless the person delivering the goods does something to remove the
transaction from the scope of the Code section. The text stated:

any other act adopting the transaction:
(b) If he does not signify his approval or acceptance to the seller but
retains the goods without giving notice of rejection, then if a time has
been fixed for the return of the goods, on the expiration of such time,
and, if no time has been fixed, on the expiration of a reasonable time.
What is a reasonable time is a question of fact.

does not distinguish the sale on approval from the sale or return, both being considered
as reserving title in the seller until buyer accepts. J. BENJAMIN, SALE OF PERSONAL

14. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS
[NCCUSL], THE REVISED UNIFORM SALES ACT: REPORT AND SECOND DRAFT 135
(1941).

15. Id. at 141 (emphasis in original).

16. AMERICAN LAW INSTITUTE [ALI], UNIFORM REVISED SALES ACT (SALES CHAP-
TER OF PROPOSED COMMERCIAL CODE): PROPOSED FINAL DRAFT No. 1, §§ 51-52 (April
27, 1944).
Between merchants there is a contract for sale or return when goods are delivered to the buyer for resale and are charged at a fixed price but even though they conform to the contract are returnable against recredit or repayment of their price in full or less minor charges. In determining whether a contract constitutes as against creditors of the buyer a sale or return, the use of such words as 'on consignment' or 'on memorandum' with or without words purporting to reserve title or property in the seller until payment or resale does not prevent the contract from being a sale or return if the buyer has a place of business at which he deals in goods of the kind involved, unless the seller establishes that the buyer is known to be engaged primarily in selling the goods of others.\(^\text{17}\)

In the same draft text the provisions on the sale or return and the sale on approval set out the special incidents followed in the present official text, but the draft continued to distinguish the two transactions by reference to location of title.\(^\text{18}\)

With minor revisions and renumbering the 1944 text was carried over to the first composite draft of the proposed Code in 1948 and to the May 1949 draft.\(^\text{19}\) The latter edition introduced extensive comments which, with minor revisions, appear as the official comments to the present promulgated text—despite subsequent revision of that text.\(^\text{20}\)

Meanwhile, references to consignments began to crop up in other parts of the proposed Commercial Code. The draftsmen of the article governing

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17. Id. § 51(2).
18. Id. § 51(1):
   A 'sale on approval' is a contract for sale under which the goods delivered, notwithstanding such use by the buyer as is consistent with their testing or trying out, are to remain the seller's until acceptance by the buyer. A 'sale or return' is a contract for sale under which the goods even though they conform to the contract and have been accepted by the buyer are subject to return at his option.

The word "and" in the second sentence is changed to "or" in the 1948 and following drafts. Query whether "and" does not make better theoretical sense?

19. ALI & NCCUSL, THE CODE OF COMMERCIAL LAW § 50(2) (1948) amends the second sentence of the 1944 draft of § 51(2) to read:
   Where the buyer has a place of business at which he deals in goods of the kind involved, such words as 'on consignment' or 'on memorandum' or other words purporting to reserve title to the seller until payment or resale are insufficient as against the buyer's creditors to keep the transaction from being a sale or return unless the seller also establishes that the buyer is known to be primarily engaged in selling the goods of others.

ALI & NCCUSL, UNIFORM COMMERCIAL CODE: MAY 1949 DRAFT WITH COMMENTS (1949) renumbers these sections as §§ 2-326 and 2-327.

20. The official comments to the present official text of sections 2-326 and 2-327 adopt the May 1949 comments with the following minor exceptions: (a) Official comment 2 to section 2-326, in the third sentence, adds references to compliance with a relevant sign law or with the filing provisions of article 9. (b) Official comment 1 to section 2-327 adds the third sentence but omits a first and third paragraphs which appear in the May 1949 comment:

   Appropriation of the goods to the contract occurs upon identification. The effect of the appropriation as provided for in this Article applies in this case as in any other.

   The return of the goods in a sale on approval is at the seller's risk and expense but the buyer must follow the seller's instructions as to this return. The policy of the Article in regard to the buyer's duties in this connection conforms to that set forth in the provision on the buyer's duties as to rightfully rejected goods.
secured commercial transactions and of the definitions in the general introductory article wrestled with the classification of consignments. In so far as the rights of third parties were concerned Tentative Draft No. 2 of August 6, 1948, which covered inventory and accounts receivable financing, specifically included within its scope the consignment of goods "whether or not the consignee is obligated to the consignor." The May 1949 draft of this scope provision is even more explicit and the draft adds a section specifically governing consignments. This latter provision distinguishes the "true" from the "false" consignment: "If the effect of a consignment is to require the consignee to pay all or a major part of the price of the goods whether or not he disposes of such goods, the consignment is deemed an inventory lien and is subject to this Part in all respects." In other words, if the transaction is a disguised security transaction, then the article on secured transactions applies in full and the sales article does not apply; if not a disguised security transaction, then the article on secured transactions does not apply except that a consignor "has the privilege of complying with filing provisions but such action does not make the other sections applicable." The draftsmen

21. ALI & NCCUSL, TENTATIVE DRAFT No. 2: ARTICLE VII—SECURED COMMERCIAL TRANSACTIONS § 301(2)(b) (Aug. 6, 1948) stated: "The provisions of this Chapter also govern . . . (b) with respect to rights of third parties, a consignment of goods whether or not the consignee is obligated to the consignor." The comment to this provision, which appears in the notes and comments to the tentative draft published on the same date, gives the following reason for including § 301(2)(b):

'Consignment,' whether or not the consignee is obligated to pay for the goods, presents the same evils as far as third persons are concerned as a sale and a lien on the goods. In both, the consignee or borrower appears to have assets which he does not have. Many states by their statutes or otherwise, require notice of consignments in the same way as they do for mortgages on goods. This provision continues that policy.

ALI & NCCUSL, NOTES AND COMMENTS TO TENTATIVE DRAFT No. 2: ARTICLE VII—SECURED COMMERCIAL TRANSACTIONS § 301, Comment 5 (Aug. 6, 1948).

22. ALI & NCCUSL, UNIFORM COMMERCIAL CODE: MAY 1949 DRAFT WITH COMMENTS § 7-304(2) (1949). Id. § 7-304(1) states:

Save as provided in subsection (2), the rights of a consignor against persons dealing with the consignee are subject to the provisions of the Article on Sales on sale on approval and sale or return (Section 2-326) except that a consignor of goods shall be deemed to have met the requirements of those provisions that the seller establish that the buyer is known to be primarily engaged in selling goods of others if he files a statement of financing as required under the provisions of this Part on filing (Sections 7-306 and 7-307).

The Comment to this section provides:

Purposes:
1. The provisions of the Article on Sales on sale on approval and sale or return provide that a consignee's creditors may reach the consigned goods in his hands unless the consignor can establish that the buyer is known to be engaged in selling the goods of others. Subsection (1) permits the consignor to meet his burden of proof by filing a statement of financing under this Part (Sections 7-306 and 7-307).

2. Some consignments are disguised security transactions. The generally accepted test is whether the consignee is obligated to pay for the goods whether or not he disposes of them. Where the consignment is in reality a security transaction, then all the provisions of this Part govern. If the consignment is not a security transaction, none of the provisions of this Part apply. The consignor has the privilege of complying with filing provisions but such action does not make the other sections applicable.

23. ALI & NCCUSL, NOTES AND COMMENTS TO TENTATIVE DRAFT No. 2: ARTICLE VII—SECURED COMMERCIAL TRANSACTIONS § 7-304, Comment 2 (Aug. 6, 1948).
were too sanguine or too explicit. The September 1949 revisions include consignments within the general definition of the scope of the article on secured transactions but quietly drop the detailed provision on consignments.\textsuperscript{24}

At the same time draft texts defining a "security interest" recognized that reservation of title by a consignor is analogous to the more explicit secured financing arrangement. The text set out in the Code of Commercial Law (1948) states:

'Registry Interest' means an interest in goods or documents of title which is limited to securing a payment or performance by another person. A security interest which rests on the reservation by a seller or consignor of property or title notwithstanding appropriation of goods to a contract for sale or notwithstanding shipment or delivery is a 'security title.'\textsuperscript{25}

With minor amendments this text was carried over into the first official Code text.\textsuperscript{26}

When, in 1952, the American Law Institute and the National Conference of State Commissioners on Uniform State Laws finally promulgated the first official edition of the Uniform Commercial Code the text included the following references to consignments: (a) section 1-201(37) defined "security interest" with a reference to the consignor; (b) section 2-326(2) [now (3)] assimilated a consignment to the sale or return; and (c) the comment to section 9-102 noted that the scope of the article included transactions in the form of consignments "if the understanding of the parties or the effect of the arrangement shows that a security interest was intended."\textsuperscript{27}

\textsuperscript{24. ALI & NCCUSL, SEPTEMBER 1949 REVISIONS § 8-102 (1949). Comment 1 to this section states:}

The test whether a transaction comes under this Article or not is twofold: Is the transaction intended to have effect as security? Is the collateral of the kind subject to this Article? ... Transactions in the form of consignments or leases may be security transactions if the understanding of the parties or the effect of the arrangement is to show that the manifest intent was to create a security interest (defined in Section 1-201(30)).

\textsuperscript{25. ALI & NCCUSL, THE CODE OF COMMERCIAL LAW § 12(4) (1948). For earlier definitions see UNIFORM TRUST RECEIPTS ACT § 1 (1933) (also drafted by Llewellyn); NCCUSL, THE REVISED UNIFORM SALES ACT: REPORT AND SECOND DRAFT § 1 (1941); ALI, UNIFORM REVISED SALES ACT (SALES CHAPTER OF PROPOSED COMMERCIAL CODE): PROPOSED FINAL DRAFT No. 1, § 12(4) (April 27, 1944).}

\textsuperscript{26. ALI & NCCUSL, UNIFORM COMMERCIAL CODE: PROPOSED FINAL DRAFT No. 2 TEXT EDITION § 1-201(37) (1951) reads:}

'Security Interest' means an interest in property which secures payment or performance of an obligation. The reservation by a seller or consignor of property notwithstanding identification of goods to a contract for sale or notwithstanding shipment or delivery is a 'security interest.'

\textsuperscript{27. UNIFORM COMMERCIAL CODE §§ 1-201(37), 2-326(2), 9-102, Comment 1 (1952 version).}
Submitted to state legislatures for their consideration, the text was the subject of searching criticism, most notably from the New York Law Revision Commission. One of the memoranda submitted to the New York Commission noted a number of inconsistencies in the texts referring to consignments. Whereas pre-Code doctrine carefully distinguished the consignee-agent, who took no title to goods on consignment from the buyer of goods, Code section 2-326(2) [now(3)] spoke of “buyers” taking “on consignment.” The memorandum noted that a narrow interpretation of the provision would give it little effect and that a broad interpretation, which would allow the consignor to escape its provisions by complying with one of three forms of publicity, might conflict with section 1-201(37) which defined a consignor’s interest as a security interest subject to article 9.28 The New York Commission’s final report called attention to these inconsistencies, stated that the Commission approved “[t]he principle of requiring that a consignor who consigns goods to an agent who maintains a place of business at which he deals in goods of the kind involved comply with Article 9 or satisfy one of the other two [notoriety] requirements,” and set out a draft text of the first three subsections of section 2-326 which the Commission recommended for adoption.29

In light of comments such as those from the New York Commission, the Code’s Enlarged Editorial Board recommended numerous changes to the 1952 text. In Supplement No. 1 published in January 1955 the Board recommended amendments to section 9-102(2) to include specifically “consignments intended as security,” and to section 1-201(37) to “make it clear that a true consignment . . . is not a secured transaction subject to all the filing, priority and enforcement provisions of Article 9.”30 With minor amendments, these proposals and the text of section 2-326 recommended by the New York Commission were promulgated in the 1957 official edition of

28. REPORT OF THE NEW YORK LAW REVISION COMMISSION FOR 1955, at 436-42 (1956). For another comment on the relation of § 1-201(37) with § 2-326 see id. at 295.

29. REPORT OF THE NEW YORK LAW REVISION COMMISSION FOR 1956, at 379-80 (1957). The text of § 2-326(3) proposed by the New York Commission has become the official text except that in the first sentence the word “When” is changed to “Where” and in the third sentence the following amendments are made:

However, this subsection is not applicable if the person making delivery

(a) complies with an [any] applicable law providing for [requiring] a consignor's interest or the like to be evidenced by a sign, or

(b) establishes that the person conducting the business is generally known [or holds himself out] by his creditors to be substantially engaged in selling the goods of others, or

(c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

(Deletions in the official text are indicated by brackets; additions by the official text are indicated by italics.)

30. ALI & NCCUSL, SUPPLEMENT NO. 1 TO THE 1952 OFFICIAL DRAFT OF TEXT AND COMMENTS OF THE UNIFORM COMMERCIAL CODE, CONTAINING FURTHER RECOMMENDATIONS OF THE ENLARGED EDITORIAL BOARD FOR AMENDMENTS OF TEXT AND ANSWERS TO CERTAIN CRITICISMS §§ 1-201(37), 9-102(2) (Jan. 1955). Among other recommendations the Board proposed the following amendments to § 1-201(37) with respect to consignments: omission in the second sentence of the phrase “or consignor of property” and the addition of a third sentence to read: “Unless a lease or consignment is intended as security, reservation of title thereunder is not a ‘security interest’ but a consignment is in any event subject to the provisions of section 2-326(2).”
the Uniform Commercial Code and remain the official text today. States adopting the Code have made no changes, with one insignificant exception, to these Code rules governing consignments.\textsuperscript{81}

More recently, the 1972 amendments to article 9 have added two sections to article 9 specifically referring to consignments. In its Preliminary Report No. 2 (1970) the Review Committee for Article 9 recommended a draft section 9-114 to resolve doubt as to whether or not a consignor could protect his interest in consigned goods against creditors of the consignee by merely filing under article 9 or whether he must also notify prior inventory secured parties.\textsuperscript{82} The Permanent Editorial Board and the sponsoring bodies not only approved this recommendation but also recommended inclusion of section 9-408 to set out the mechanics of filing a consignment statement to avoid any presumption that a consignment is intended for security by the mere fact of filing under article 9.\textsuperscript{83} So far fourteen states have adopted these 1972 amendments without change.

B. Sale on Approval\textsuperscript{84}

A “sale on approval” under the Uniform Commercial Code is a special form of contract for sale.\textsuperscript{35} It differs from a regular contract for sale in that (a) the buyer in a sale on approval takes goods primarily for use, whereas a buyer in a regular sale is not so limited; (b) the buyer on approval may return the goods after trial even if they fully conform to the contract description, whereas a buyer normally has a right of inspection but a right to reject only if the goods are nonconforming; and (c) the sale on approval is subject to the special incidents set out in section 2-327(1) which differ from those of a regular contract for sale. Like the consignment, the sale on approval transfers possession of the goods from the owner to the other party to the transaction and that other party has the right to return the goods to the owner and, thus, relieve himself from any obligation with respect to the goods. The sale on approval differs from a consignment, however, in that the goods on approval are not subject to the claims of buyer's creditors while in

\begin{itemize}
  \item [31.] \textit{Uniform Commercial Code} $\S$ 2-326(3)(a), which permits consignor to avoid subsection (3) by complying with an applicable sign law, is omitted in the California enactment of the Uniform Commercial Code because California has no sign law and it was felt that the reference “might create confusion.” \textit{Cal. Comm. Code Ann.} $\S$ 2326, California Code Comment 5 (1964).
  \item [32.] \textit{Review Committee for Article 9, Preliminary Report No. 2}, $\S$ 9-114 (1970). The text is also published in 25 \textit{Bus. Law.} 1067, 1117-18 (1970). The official 1972 text of the Code changes the word “debtor” to “consignee” in $\S\S$ 9-114(1)(a), (c) and (d), but otherwise adopts the Review Committee's text without change. The official text does add paragraph 4 to $\S$ 9-114, Comment 1. [The 1972 official text of the Uniform Commercial Code will hereinafter be cited as UCC. All other drafts will be so designated]. \textit{See Anderson, Proposed Section 9-114 of the Uniform Commercial Code: The Consignor's Priority in his Goods}, 8 \textit{Loyola of L.A.L. Rev.} 139 (1975).
  \item [33.] UCC $\S$ 9-114, 9-408.
  \item [34.] For a brief discussion of the “sale on approval,” with emphasis on the historical and comparative perspective, see Murray, \textit{Sale or Return and Sale on Approval of Goods}, 1962 \textit{Wis. L. Rev.} 93.
  \item [35.] UCC $\S$ 2-326, Comment 1, ¶ 3 observes that the section “nevertheless presupposes that a contract for sale is contemplated by the parties although that contract may be of the peculiar character here described.”
\end{itemize}
his possession (section 2-326(2)), whereas consigned goods are subject to the claims of consignee’s creditors if the consignment falls within the scope of section 2-326(3). Examples of a sale on approval included the manufacturer who takes a machine on trial and the housewife who takes home a dress to test its effect on her husband.

The provisions governing the sale on approval have generated remarkably little litigation and commentary. Perhaps even more than in the ordinary sale between merchants, the sale on approval to a merchant or a non-merchant consumer puts pressure on the parties to negotiate. The seller realizes he is gambling that a demonstration of the goods will persuade the customer to accept. Also, the period of trial allows for adjustments both to the goods and the deal by the seller, who may hope that with a foot in the door he can still make a sale.

Most of the specific rules in sections 2-326 and 2-327 with respect to the sale on approval codify prior law. Traditionally, many of the rules were explained by reference to seller’s retention of title until buyer accepted. The buyer’s creditors had no claims to the goods until acceptance; seller had the risk of loss until acceptance; if buyer elected to return the goods the seller bore the risk and expense of the return of “his” goods. The Code adopts these rules and, oddly enough, considering the de-emphasis on “title” in the Code generally, notes that title does not pass to buyer until acceptance, although the Code makes nothing turn on the retention of title.

In theory perhaps the most difficult rule to justify is the rule that creditors of the buyer have no claims to the goods in buyer’s possession until acceptance. In other contexts, for example the consignment, the law is eager to protect the creditors of a person who has ostensible ownership of goods by virtue of his possession of them. Here, not only does buyer have possession, but by definition he is using the goods or trying them out. In practice this may not raise many problems because the trial period will be relatively short and the process of testing may itself call attention to the buyer’s limited rights. In one recently reported case where seller and creditor of the buyer both claimed the goods in buyer’s possession, the court found that buyer had accepted the goods by the lapse of two months without exercising his election to return them and, therefore, the creditor’s claims to the goods prevailed.


38. UCC § 2-327(1)(a).

39. Valley Bank & Trust Co. v. Gerber, 526 P.2d 1121, 15 UCC Rep. Serv. 1035 (Utah 1974). See also Akron Brick & Block Co. v. Moniz Engineering Co., 310 N.E.2d 128, 14 UCC Rep. Serv. 563 (Mass. 1974), where Mr. Justice Braucher, who when a professor had been active in drafting the Code, found that there had been an acceptance under the facts of that case whether the contract was a contract for sale or a sale on approval. Under the contract terms, the seller remained the owner until the price was fully paid, but if the machine did not meet the approval of the buyer, seller agreed to “refund the down payment, including Engineering charges.”
C. Sale or Return

A "sale or return" under the Uniform Commercial Code is a regular contract for sale with the special feature that the buyer has the option to return the goods in lieu of payment even if they conform to the contract. The buyer takes the goods primarily for resale and is, therefore, in most cases a merchant. Functionally, the sale or return is like the consignment in that it places goods in the hands of a retailer who has the power to return unsold goods. Recognizing the similarity of the two marketing forms, the Code draftsmen assimilated the consignment to the sale or return with respect to the claims of retailer's creditors to the goods while in retailer's possession. The Code, however, prescribes additional rules for the sale or return.

General sales provisions apply to the sale or return except for the special rules which follow from the option to return. The risk of loss will be allocated between the seller and buyer in accordance with the general rules set out in section 2-509, but, unless otherwise agreed, the buyer will bear the risk of loss and expense when exercising his option to return the goods pursuant to section 2-327(2)(b). While the goods are in buyer's possession they are subject to the claims of his creditors in accordance with section 2-326(2). After making delivery the seller cannot unilaterally reclaim the goods. Most of these rules follow pre-Code law, which explained them doctrinally by locating title in the buyer.

The Code makes some changes from prior law. The draftsmen considered the "or return" term as so contrary to commercial practice that section 2-326(4) treats the term as a separate contract for the purposes of the statute of frauds and as contradicting the sale aspect for the purposes of the parol evidence rule. As a result, where written contracts are involved the agreement permitting the return of conforming goods must be in writing. In

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40. See 1 R. Anderson, supra note 36, §§ 2-326, -327; R. Duesenberg & L. King, supra note 36, § 11.04; Murray, supra note 34. 41. UCC § 2-326, Comment 1 notes that the sale or return transaction is "so strongly delineated in practice and in general understanding that every presumption runs against a delivery to a consumer being a 'sale or return.'" 42. Confusion between the "sale or return" and the consignment transaction "deemed" a sale or return "with respect to claims of [consignee's] creditors" under UCC § 2-326(3) plagues analysis. This confusion mars, for example, the stimulating analysis in Comment, Consignments and Similar Transactions Under the Uniform Commercial Code, 68 COLUM. L. REV. 1210, 1210-13 (1968). Several court decisions do note the distinction. In re A & T Kwik-N-Handi, Inc., 13 UCC Rep. Serv. 779 (M.D. Ga. 1973); American Nat'l Bank v. First Nat'l Bank, 476 P.2d 304, 8 UCC Rep. Serv. 287 (Colo. Ct. App. 1970). The court in the latter case states: 'Sale or return' under subsection (1) [of section 2-326] is not defined in the Code. However, a 'sale or return' transaction is not a new concept in Colorado law. A 'sale or return' is a contract for sale or [sic] goods whereby title passes immediately to the buyer subject to his option to rescind or return the goods if he does not resell them, . . . Section 2-326 (2) provides that goods held on sale or return are subject to the claims of the buyer's creditors while such goods are in the buyer's possession. The exceptions set forth in subsection (3), (a), (b), (c) apply only to transactions covered by subsection (3) and do not apply to a sale or return under subsection (1).

Id. at 309, 8 UCC Rep. Serv. at 289. 43. L. Vold, supra note 37, at 381-87; 2 S. Williston, supra note 37, §§ 270-73. 44. UCC § 2-326, Comment 3. For Professor Williston's adverse comment on this change see Williston, The Law of Sales in the Proposed Uniform Commercial Code, 63 HARV. L. REV. 561, 580 (1950).
some jurisdictions title revested in the seller when buyer delivered to a
carrier for shipment to the seller; in resolving the conflict in prior law, the
Code requires the actual return of goods to the seller before the buyer is
relieved of his obligations.\textsuperscript{45}

A more basic change, however, is in the conceptual distinction between
the sale on approval and the sale or return. Under pre-Code law the
distinction turned on whether or not the seller intended to part with title;
whether the buyer purchased for use or for resale made no legal difference.
Early drafts of section 2-326(1) set out a functional distinction, but also
differentiated the two transactions in terms of ownership:

A 'sale on approval' is a contract for sale under which the goods
delivered, notwithstanding such use by the buyer as is consistent with
their testing or trying out, are to remain the seller's until acceptance
by the buyer. A 'sale or return' is a contract for sale under which
the goods even though they conform to the contract or have been ac-
cepted by the buyer are subject to return at his option.\textsuperscript{46}

Commenting on this draft, a memorandum to the New York Law Revision
Commission pointed out that here the intent of the parties as to location of
title remained important, whereas in most of the Code “title” is down-
played.\textsuperscript{47} In its final report the New York Commission recommended the
distinction which now appears as section 2-326(1) and which abandons
location of title as a test.\textsuperscript{48}

According to the official comment to section 2-326, the transaction
originally contemplated by the draftsmen is where the seller overcomes the
unwillingness of a merchant to risk marketing the goods by giving the buyer
the option to return the goods.\textsuperscript{49} The buyer would be obligated to pay
the agreed wholesale price to the seller but would be free to fix the retail
price of “his” goods unless he had otherwise agreed by a valid retail price
maintenance contract. If buyer sold the goods, he kept the difference
between the retail and wholesale prices; if he failed to sell the goods,
he could return those which were substantially in their original condition in-
stead of paying the wholesale price. If, despite the delivery of the goods to the
retailer, the original seller purports to retain title to the goods this is limited in
in effect under the Code to reservation of a security interest which attaches
and is perfected pursuant to the provisions of article 9.\textsuperscript{50} The notice provi-

\textsuperscript{45} UCC § 2-327(2)(b), Comment 4. For a brief discussion of pre-Code split of
authority see L. Vold, \textit{supra} note 37, at 383.
\textsuperscript{46} ALI & NCCUSL, \textit{Uniform Commercial Code: May 1949 Draft with Com-
ments} § 2-326(1) (1949). For the origin of this text see note 18 \textit{supra}.
\textsuperscript{47} 1 \textit{Report of the New York Law Revision Commission for 1955}, at 436
(1956).
(1957).
\textsuperscript{49} UCC § 2-326, Comment 1 states: "The type of 'sale or return' involved herein
is a sale to a merchant whose unwillingness to buy is overcome only by the seller's en-
gagement to take back the goods (or any commercial unit of goods) in lieu of payment
if they fail to be resold."
\textsuperscript{50} UCC § 2-401(1) provides a rule as to the reservation of title: "Any retention
or reservation by the seller of the title (property) in goods shipped or delivered to the
buyer is limited in effect to a reservation of a security interest." This provision will
sions of section 2-326(3) are not open to the seller in his competition for
the goods with buyer's creditors.51

Like the sale on approval, the "true" sale or return makes only rare
appearances in the court reports and Code commentaries. Businessmen
probably ignore the subtleties of the distinction made by the Code between
the sale or return and the consignment transaction. On occasion courts have
also not recognized the subtleties. Because the Code gives businessmen
freedom to contract out of most Code rules,52 the Code distinctions may
be less important for resolving disputes between the manufacturer or
wholesaler and the retailer. But when the claims of creditors intervene,
the Code substantially curtails or conditions this freedom to contract out
of the Code rules. The legal adviser's task of planning a marketing distri-
bon system which fully protects his client and which complies with the
law is made more difficult not only by the difficulty of distinguishing the
sale or return and the consignment but also, as outlined below, by the con-
fusion over the rules governing the rights of consignor, consignee, and con-
signee's creditors.

II. THE CONSIGNMENT

Nowhere in the Uniform Commercial Code is there a definition of
"consignment."53 The definitional cross-reference to section 9-114 sends the
hopeful reader to the definition of "security interest" in section 1-201(37),
which has the following delphic reference to consignments: "Unless a lease
or consignment is intended as security, reservation of title thereunder is not a
'security interest' but a consignment is in any event subject to the provisions
on consignment sales (Section 2-326)." Apparently there are (a) consign-
ments "intended as security" which fall under article 9 by virtue of sections
1-201(37) and 9-102(2), and (b) "true" consignments not intended as
security which are regulated by section 2-326.54

Although the distinction between "true" and "false" consignments has
practical consequences under the Code, the Code provisions give no guide-
lines for determining whether or not a particular consignment arrangement is
"intended as security." Commentators and a few courts have suggested
various tests, but most courts have not stopped to determine the classification

51. See note 42 supra.
52. UCC §§ 1-102(3) and (4); see the discussion of these Code policies at notes
68-80 infra and accompanying text.
53. The definitions of "consignor" and "consignee" set out in UCC §§ 7-102(1)(b)
and (c) relate to the consignor and consignee where a bill of lading is involved.
54. Indeed, there is a third class of consignments, neither intended as security nor
falling within the scope of the first sentence of UCC § 2-326(3). For example, a con-
signment of goods to a person with directions to repair and store the goods would not
be within § 2-326(3). As a "transaction in goods" (id. § 2-102) a consignment in this
third class may be subject to provisions in article 2 which do not specifically refer to
a "contract for sale" (id. § 2-106(1)). The notorious "unconscionability" provision set
out in id. § 2-302, for example, may govern not only the contract for sale but also all
transactions in goods.

be relevant for a sale or return but not for a consignment because consignor and con-
signee are not "seller" or "buyer" within the definitions of id. §§ 2-103(1)(d) and (a).
Note also the definition of "sale" in id. § 2-106(1): "A 'sale' consists in the passing
of title from the seller to the buyer for a price (section 2-401)."
of the consignment arrangement before them. As a result most reported cases have applied the section 2-326(3) rules, and while they have fleshed out the wording of that provision, they have not developed a test for determining whether or not a consignment is intended as security. Uncertainty about the scope and meaning of the Code's provisions continues.

In this part I first examine the consequences of classifying a consignment as either "true" or "false," then analyze several proposed tests for determining the classification, and end with a survey of section 2-326(3) as developed by court decisions.

A. Consequences of Classifying the Consignment

If the consignment is found to be "intended as security" all the provisions of article 9 apply. The reservation of title under such a consignment is a security interest explicitly made subject to article 9 by section 9-102(2) defining the scope of that article. To perfect this security interest consignor must file pursuant to part 4 of article 9. Priority of the consignor's claims to the goods will be determined in accordance with the relevant provisions of article 9 and on default the rights and duties of consignor and consignee will be subject to the limitations prescribed in part 5 of that article. Although it has been suggested that language in section 1-201(37) also requires consignor to comply with section 2-326(3), this would be of no practical importance because that section does not add to the rights or duties of a consignor whose consignment is intended as security.

55. UCC § 9-102(2) states: "This Article applies to security interests created by contract including...consignment intended as security."

56. UCC § 9-401 will govern the place of filing. The consignor will normally supply "goods" (id. § 9-105(1)(f)) which will be "inventory" (id. § 9-109(4)) in the hands of consignee. As a result, in most states filing will be in a central office. See the three alternative subsections to id. § 9-401(1) permitted by the Code.

57. The consignment "security interest" should be found to be a "purchase money security interest" as defined in UCC § 9-107 despite some stretching of the wording of that section. Section 9-107 states:

A security interest is a 'purchase money security interest' to the extent that it is
(a) taken or retained by the seller of the collateral to secure all or part of its price; or
(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

The word "seller" in subsection (a) should be read to include the consignor. By determining that the consignor has parted with all but a security interest in the goods the Code has determined that the transaction is functionally the equivalent of a sale with a retained security interest. The more narrow definition of "seller" in id. § 2-103(1)(d) governs only article 2 and has not been incorporated into article 9 by reference (id. § 9-105(3)). Less persuasively, it has been suggested that consignor "gives value to enable the debtor to acquire rights in...[the] collateral" but it distorts what actually happens to say consignor does so "by making advances or incurring an obligation." As a purchase money secured party, consignor will be subject to id. §§ 9-301(2) and 9-312(3) as well as the more general priority rule set out in id. § 9-312(5). See also note 67 infra; cf. Manufacturers Acceptance Corp. v. Penning's Sales, Inc., 5 Wash. App. 501, 487 P.2d 1053, 1057-58, 9 UCC Rep. Serv. 797 (1971).

58. Comment, supra note 42, at 1211, calls attention to the phrase "a consignment is in any event subject to the provisions on consignment sales" in UCC § 1-201(37) (emphasis added). This note suggests that the phrase means that all consignments are subject to id. § 2-326(3). A better reading is to read the sentence as a whole: despite the fact that a reservation of title in a consignment not intended as security is not
If, however, the consignment is not intended as security it will be subject to section 2-326(3). The official text of that section states:

Where goods are delivered to a person for sale and such person maintains 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, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The 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' or 'on memorandum.' However, this subsection is not applicable if the person making delivery

(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or

(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or

(c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

Under subsection (2) goods held on sale or return are subject to the claims of buyer's (consignee's) creditors while in his possession. In other words, if consignor delivers goods to a consignee who fits the description in the first sentence of subsection (3), consignor's goods will be subject to the claims of consignee's creditors unless the consignor meets the notoriety requirements set out in the third sentence of that subsection.

One of the ways which consignor may protect his interests is by filing under article 9 pursuant to section 2-326(3)(c). Whether this filing subjects the consignment not intended as security to the non-filing provisions of article 9 has caused concern. Clearly if consignor chooses to comply with the filing provisions of article 9 the relevant provisions of part 4 (filing) of article 9 will apply: the place of filing, form of statement, duration of filing, etc., will be governed by the rules set out in that part.\footnote{a “security interest,” the consignor will be subject to § 2-326(3) with respect to the rights of consignee's creditors and will not escape the Code altogether. In any event, the phrase has caused the courts no trouble. See also Annot., Consignment Transactions Under the Uniform Commercial Code, 40 A.L.R.3d 1078, 1087 n.8 (1971).}

The wording and legislative history of the Code suggest that only these article 9 filing provisions are to apply to a “true” consignment. Section 2-326(3)(c) itself refers only to the filing provisions. If a “true” consignor files, then subsection (3) “is not applicable”; the consignment will not be deemed a sale or return; the consigned goods will not be subject to the claims of consignee's creditors while in his possession; pre-Code general principles of law will govern; pursuant to these general principles consignor will

\footnote{Because a consignment intended as security is subject to the filing requirements of article 9 (i.e., UCC § 9-302(1)), the consignor should not prevail over creditors by complying with id. §§ 2-326(3)(a) or (b). On this point the court in In re De'Cor Wallcovering Studios, Inc., 8 U.C.C. Rep. Serv. 59 (E.D. Wis. 1970), is wrong.}

\footnote{59. UCC § 9-408, introduced in the 1972 official text, supplements these rules by permitting the substitution of the words “consignor” and “consignee” for “secured party” and “debtor” in the statements filed.}
be able to reclaim "his" goods not only from consignee's unsecured creditors, but also from his secured creditors and his trustee in bankruptcy. Legislative history also suggests this limited reading. Section 1-201(37) was amended in 1957 to make clear that a consignment not intended as security is "not a secured transaction subject to all the filing, priority, and enforcement provisions of Article 9."60

Several commentators, however, have suggested that other article 9 provisions should also apply to the true consignment,61 and several courts have adopted this suggestion, especially with respect to application of section 9-301.62 In support of this suggestion two anomalies are noted. Under section 2-326(3) the consigned goods are subject to the claims of both secured and unsecured creditors,63 whereas the consignor in a consignment intended as security will prevail over unsecured creditors even though he may not have perfected his security interest by filing.64 Likewise, while article 9 sets out time limits on filing and subordinates claims based on late filing, section 2-326(3) is silent. Read literally section 2-326(3) would permit the consignor, by filing at the last moment, to snatch the consigned goods from the grasp of creditors and even from the trustee in bankruptcy. Given that subsection (3) was designed to protect creditors from such secret reservations, permitting the consignor to file long after the consignee has received possession of the goods is an undesirable result which can be avoided by applying sections 9-301, 9-312 and related provisions.65

Legislative history gives some support to the argument for application of non-filing provisions of article 9 to the "true" consignment. Prior to 1972 commentators debated inconclusively over whether or not a "true" consignor was required to notify a secured financer of consignee's inventory whose agreement included an after-acquired property clause, just as a party with a purchase money security interest would be required to do in accordance with section 9-312(3).66 Section 9-114 has now settled this debate by accepting the view that the filing rule in section 2-326(3)(c) not only requires filing

60. New UCC § 9-408 also states that if a consignment is filed, and is later found to be intended as security, the filing will perfect the consignor's interest, implying that the "true" consignment is not otherwise perfected by filing.


63. UCC § 2-326(3) refers to the term "creditors," which is defined in id. § 1-201 (12) to include both general and secured creditors. Official Comment 2 to § 2-326 speaks of "general creditors" but this comment is not binding and the text controls. This point is recognized by the court in American Nat'l Bank v. Tina Marie Homes, Inc., 476 P.2d 573, 8 UCC Rep. Serv. 281 (Colo. Ct. App. 1970).

64. UCC §§ 9-201 and 9-301, when read together, imply that an unperfected security interest is not subordinated to a general creditor before the latter becomes a lien creditor as defined in § 9-301(3).

65. King, supra note 61, at 936, suggests that decisions interpreting pre-Code chattel mortgage statutes to invalidate unfiled mortgages might apply to the analogous language in UCC § 2-326(3). See also Duesenberg, supra note 10, at 260, for a similar suggestion. Duesenberg adds that "bearing in mind that the Code allows advanced filing, it is not inconceivable that the time to be allowed will be zero days." Id. The suggestion, however, ignores the alternative that many consignors will have to dispute a claim of consignee's creditors under § 2-326(3)(b).

66. King, supra note 61, at 935; Comment, supra note 42, at 1215.
under part 4, but also requires notice to prior inventory secured parties.\(^{67}\) That the draftsmen nevertheless provide only for the inventory-secured creditor suggests, however, that this legislative history is inconclusive.

On the whole, the arguments for limiting the application of article 9 to its part 4 filing provisions are more persuasive. Anomalous cases should be provided for by amendments but to ignore the Code's wording and explicit legislative history is to create unnecessary uncertainty. If, therefore, the consignment is not intended as security, the consignor may protect himself from the claims of consignee's creditors by filing under article 9 without thereby subjecting the consignment to all the provisions of that article.

Assuming the above analysis is correct, the more specific consequences of denominate a consignment as "true" or "false" may be summarized by looking at the relations between the parties, the rights of creditors, and the rights of purchasers.

**Relations Between the Parties.** Despite its detailed provisions, the Uniform Commercial Code reaffirms from the first the general freedom of the parties to determine their obligations *inter se*. Subsections (3) and (4) of section 1-102 state unambiguously: "The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act. . . . The presence in certain provisions of this Act of the words 'unless otherwise agreed' or words of similar import does not imply that the effect of other provisions may not be varied by agreement under subsection (3)." The Code encourages the growth of commercial practices within its general framework and recognizes that this freedom to contract is an important factor in the growth of these practices. Only with respect to very important matters does the Code restrict this freedom.\(^{68}\) The Code may restrain the parties in order to discourage fraud and protect debtors from the superior bargaining power of their creditors. Thus, among the restrictions are rules requiring a written memorandum of the parties' agreement and those provisions in part 5 of article 9 with respect to procedures on default by a debtor in a security agreement.

While permitting the continued expansion of commercial practices, the Code does not abolish the past. Prior law is simplified, clarified, and modernized, but existing general principles, including the law of principal and agent, continue to supplement the Code's provisions.\(^{69}\)

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\(^{67}\) The reasons for the 1972 adoption of new section 9-114 are set forth in ALI & NCCUSL, **UNIFORM COMMERCIAL CODE—1972 OFFICIAL TEXT**, and state: "An uncertainty has existed under the 1962 Code whether the filing rule in Section 2-326(3) applicable to true consignments requires only filing under Part 4 of Article 9 or also requires notice to prior inventory secured parties of the debtor under Section 9-312(3). The new Section 9-114 accepts the latter view . . . ." This result supports the suggestion in note 57 supra that the consignment intended as security is a "purchase money security interest" because otherwise a "true" consignment would be subject to greater restrictions than the security consignment.

\(^{68}\) See, e.g., UCC § 2-718(1) with respect to liquidation or limitation of damages. *See also id.* § 2-616(3) with respect to seller's excuse for non-delivery.

\(^{69}\) UCC §§ 1-102(2)(a), 1-103. The latter provision states: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant, and the law relative to . . . principal and agent . . . shall supplement its provisions."
extent that the consignment is recognized as an agency relationship these
general uncodified principles continue to govern the consignment transaction
except where displaced by Code provisions.

Within the parameters of these general policies, whether or not a consign-
ment is classified as a secured transaction gives rise to several practical
consequences. If subject to article 9, the consignment must be evidenced by a
written memorandum and the parties may not waive certain rights and
obligations on default; if subject only to article 2, the parties are not required
to have a written agreement and are free of restrictions regarding the waiver
of rights and obligations on default.

Surprisingly, the consignment not intended as security falls outside the
scope of the statute of frauds provisions in the Code. Section 2-326(3)
deems a consignment a sale or return only “with respect to claims of creditors” and, therefore, the special statute of frauds provision applicable to
a contract for sale with an “or return” term does not include the consignment
within its scope.\(^7\) Nor are the more general statute of frauds provisions
relevant. Section 2-201 covers only “a contract for sale of goods for the price
of $500 or more” and section 1-206 applies only to “a contract for the sale
of personal property.” If the consignment is intended as security, however,
the parties will have to put their agreement in writing in accordance with
section 9-203 irrespective of the value of the goods and despite delivery of
the goods to the consignee.\(^7\)

A much more important difference between falling under article 9 and
article 2 lies in the remedies available to the consignee if the consignment is
found to be intended as security. Part 5 of article 9 sets out the rights and
remedies of the parties on default, and while the parties’ agreement may
provide details, section 9-501(3) specifically limits the right of the parties to
vary the part 5 rules listed in that subsection. One commentator, emphasizing
the “realities of the commercial world,” argues that businessmen should be
permitted knowingly to waive these protective measures if the transaction is
cast in an “agency” rather than a “sale” mold.\(^7\) The Code’s policies

70. UCC § 2-326(4). This subsection states: “Any ‘or return’ term of a contract
for sale is to be treated as a separate contract for sale within the statute of frauds sec-
tion of this Article (Section 2-201) and as contradicting the sale aspect of the contract
within the provisions of this Article on parol or extrinsic evidence (Section 2-202).”

71. See UCC § 9-203, Comment 5. See also In re De’Cor Wallcovering Studios,
Inc., 8 UCC Rep. Serv. 59 (E.D. Wis. 1970), where the court held that an oral consign-
ment arrangement not used by the consignor to fix prices was a consignment intended
as security which was invalid because § 9-203 requires a writing. Note that the 1972
amendments to § 9-203 do not amend the requirement that the security agreement be
in writing where the secured party (consignor) does not have possession of the
collateral. All commentators agree that consignor does not have “possession” of the
goods in the hands of the consignee despite the principal-agency relationship of the two
parties.

72. Duesenberg, supra note 10, at 238-39. Duesenberg argues:
So long as a transaction is not deceptive and a fraud on third parties, the
writer knows of no persuasive reason why the parties to a contract may
not willingly agree to a form of agreement which does not fall within Arti-
cle 9, and therefore which avoids the unalterable remedies provisions of
that article. To be sure, those sections are designed in large part to pro-
tect the interests of the debtor for good policy reasons. But the notion
that debtors are always the ones in need of legislative protection is quickly
dispelled with exposure to the realities of the commercial world; if the
favoring freedom of contract and growth of commercial custom cut both ways. On the one hand, it might be argued that these policies suggest reading narrowly the scope of mandatory provisions. On the other hand, the very reluctance of the Code to limit this freedom itself indicates the importance attached to these restrictions and suggests they should be read broadly to give them full effect. Thus, one would argue that the mandatory provisions which protect the debtor from a secured party in a superior bargaining position after default should be read broadly to protect the consignee from the demands of the consignor when the consignor wishes to retake the goods for any reason.

**Rights of Creditors.** The Code is solicitous of the rights of creditors. The claims of creditors to goods as they move from seller to buyer is spelled out in article 2 on sales. The legal rules governing security interests in personal property are revised and simplified by article 9. Notice to creditors is key: claims to goods must be publicized by public filing or by having the goods out of the possession of the debtor. Hidden claims to goods ostensibly owned by another by virtue of the latter's possession of the goods are subordinated to the claims of creditors who might be misled.

Critics of the consignment under pre-Code law noted that many so-called consignment arrangements were functionally similar to conditional sales, but whereas conditional sales had to be recorded publicly, the consignor's claims to the goods had to be recorded in only a few states. The Code draftsmen parties knowingly desire to avoid these protective measures, if due protection is afforded third parties, and if the delivering party in fact insists on conduct under the agreement that would show an agency relationship, little but an emotional attachment to the policy behind the -500 series of Article 9 remains for arguing that those sections may not be avoided.

*Id.* at 238 n.35.

The practical difficulty of bringing the consignment arrangement within article 9 is highlighted by the question of "default." Article 9 does not define default, leaving it to the parties to define events of default. Standard form security agreements contain detailed, carefully drafted clauses governing default. Consignment agreements are not normally drafted with the same attention to "default" vocabulary.

73. Liebowitz v. Voiello, 107 F.2d 914 (2d Cir. 1939); NCCUSL, THE REVISED UNIFORM SALES ACT: REPORT AND SECOND DRAFT 141 (1941); 1 G. Gilmore, SECURITY INTERESTS IN PERSONAL PROPERTY, 73-75 (1965).

74. G. Gilmore, supra note 73, at 74. Consignor could recover "his" goods from consignee's trustee in bankruptcy. Ludvigh v. American Woolen Co., 231 U.S. 522 (1913). Most commentators concluded under pre-Code law that this repossession of goods was not a voidable preference under § 60a of the Bankruptcy Act, 11 U.S.C. § 96 (1970), because there is no "transfer" within the meaning of § 1(30) of that Act, 11 U.S.C. § 1(30) (1970). See 3 W. Collier, BANKRUPTCY § 60.44 (14th ed. J. Moore & L. King 1975). More recently, several commentators have questioned whether the Code will change this result. Professor Kennedy suggests that repossession or "perfection" of consignor's rights is "a transfer to one [consignor] standing in the position of a creditor" and that the critical question is "whether the owner's acquisition is rightful and legally effective to terminate the erstwhile possessor's [consignee's] interest in the goods." Kennedy, The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9, 14 RUTGERS L. REV. 518, 563 (1960). Professor King notes also that unless consignor complies with the filing provisions of UCC § 2-326(3)(c) prior to consignee receiving possession of the goods consignor might lose to consignee's trustee in bankruptcy under either Bankruptcy Act §§ 70c, 70e, or 60, 11 U.S.C. §§ 110(c), (e), or 96 (1970). King, supra note 61, at 936-38. See also Hawkland, The Impact of the Commercial Code on the Doctrine of Moore v. Bay, 67 COM. L.J. 359, 362 (1962); Shanker, Bankruptcy and Article 2 of the Uniform Commercial Code, 40 REF. J. 37, 37-39 (1966); Shinberg, Consignment Sales in Bankruptcy, 63 COM. L.J. 93 (1958).
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recognized this criticism and drafted section 2-326(3) to deal with "cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation." 75

Under the Code the consignor's claims must be publicized whether or not a consignment is found to be intended as security. If the consignment is not intended as security, under section 2-326(3) the goods will be subject to the claims of consignee's creditors while they are in his possession unless the consignor (a) complies with an applicable sign law, 76 (b) establishes that the consignee is "generally known by his creditors to be substantially engaged in selling the goods of others," or (c) complies with the filing provisions in article 9. Section 9-114 now also states that a "true" consignor's interest will be subordinate to a secured party who would have a perfected security interest in the goods if they were the property of consignee unless the consignor (a) files before the consignee receives possession of the goods and (b) gives written notification to the prior secured party. If a consignment is intended as security, all the provisions of article 9 apply, including those which require the filing of a public notice and those which set out the rules of priority. Before filing, the consignor's claims will be effective according to the terms of the consignment agreement as between the consignor and unsecured creditors of consignee. 77 However, because prior to filing consignor's claims will be subordinate to lien creditors, including a trustee in bankruptcy, in practice consignee's creditors will have effective claims to the consigned goods. 78

While both article 2 and article 9 require the consignor to publicize his claims, the article 2 notoriety provisions are more primitive. The "true" consignor is not obliged to file under article 9 but may rely instead on a sign law or on consignee's general reputation among creditors. Moreover, section 2-326(3) sets no time limit for filing and thus raises the possibility that consignor may avoid the claims of consignee's creditors by filing long after the consignee received possession. Section 9-114 now protects a secured party with an interest in consignee's inventory, but the claims of general creditors and the trustee in bankruptcy may still be upset if section 2-326(3) is read literally.

Transfers by Consignee to Third Parties. A basic Code policy is to protect

75. UCC § 2-326, Comment 2. The policy behind § 2-326(3) has been recognized by the courts. As one court has said:

Regardless of how desirable this conceptualization of a consignment contract [as an agency or bailment relationship] is from the point of view of the consignor, it violates the principle of apparent or ostensible ownership: People should be able to deal with a debtor upon the assumption that all property in his possession is unencumbered, unless the contrary is indicated by their own knowledge or by public records.


76. As explained in the text accompanying notes 99-114 infra, the "sign law" referred to in UCC § 2-326(3)(a) means a statute providing for the consignor's interest to be publicized. Only two states have such statutes. See In re Levy, 3 UCC Rep. Serv. 291 (E.D. Pa. 1965).

77. UCC §§ 9-201, 9-301; see note 64 supra.

78. UCC § 9-301(1)(b).
purchasers who buy in the ordinary course of business out of inventory. 79
The purchaser from a consignee is, therefore, protected whether or not the
consignment is intended as security. Section 2-403(2) explicitly states the
principle: “Any entrusting of possession of goods to a merchant who deals in
goods of that kind gives him power to transfer all rights of the entruster to a
buyer in ordinary course of business.” As the official comment notes, the
consignor cannot complain about this rule because “the very purpose of
goods in inventory is to be turned into cash by sale.” 80 Likewise, under
section 9-307(1) the buyer in ordinary course takes free of a security
interest even if it is perfected and even if the buyer knows of the security
interest.

B. Finding the “True” Consignment

As the above discussion illustrates, whether or not a consignment is
intended as security does have some practical consequences under the Code.
On their face the consequences do not appear to be of great weight and some
anomalous differences may have been unintended by the draftsmen. How-
ever, given that the Code does distinguish a “true” from a “false” consign-
ment, courts and commentators who have considered the problem have
found it necessary to elaborate on the “intended as security” language. There
is no consensus on a test, but the field has been ably surveyed from different
vantage points by Professor Hawkland and Mr. Richard Duesenberg. These
tests are easily stated. Professor Hawkland suggests the following functional
test: whether the parties use the consignment as a concession to dealers who
are unwilling to assume the risk of finding a market for the goods (a consign-
ment intended as security) or use the device as a price-fixing arrangement
(a “true” consignment). 81 Duesenberg proposes that the test should be
whether or not consignor and consignee establish in word and deed that they
stand in relation to each other as principal and agent. 82

79. UCC § 2-403, Comment 2 states: “The many particular situations in which a
buyer in ordinary course of business from a dealer has been protected against reservation
of property or other hidden interest are gathered by subsection (2)-(4) into a single
principle protecting persons who buy in ordinary course out of inventory.” UCC § 1-201
(9) defines “buyer in ordinary course of business.”
80. Id.
81. Hawkland, The Proposed Amendments to Article 9 of the UCC—Part 5: Con-
signments and Equipment Leases, 77 COM. L.J. 108 (1972); Hawkland, Consignments
under the Uniform Commercial Code: Sales or Security?, UNIFORM COMMERCIAL CODE
CO-ORDINATOR ANN. 395 (1963); Hawkland, Consignment Selling Under the Uniform
Commercial Code, 67 COM. L.J. 146 (1962). Note the similarity of Hawkland’s test
with the reason given for including the “sale or return” in UCC § 2-326, Comment 1.
82. R. DUESENBERG & L. KING, supra note 36, § 11.03[2]; Duesenberg, supra note 9;
Duesenberg, supra note 10. A former law professor, Mr. Duesenberg is now in pri-
vate practice. This different perspective is no doubt important. One very practical con-
sequence of the Hawkland test is that price-fixing consignment marketing schemes,
which are the only consignments subject to UCC § 2-326 according to Hawkland, run
into antitrust prohibitions. See cases cited supra note 10. At the same time, consign-
ments intended as security are in effect "sales with reservation of a security interest" and
if consignor reserves power to fix retail prices there is an even clearer violation of
land Code interpretation would be to prohibit virtually all consignment marketing opera-
tions. This fear may underlie many of Duesenberg’s objections to Hawkland’s analysis
and Duesenberg’s emphasis on “agency.”

The Supreme Court may still permit an agency consignment if used not solely to per-
Professor Hawkland relies heavily on legislative history for his test. He notes that initially section 1-201(37) made all consignments "security interests." The provision had to be changed because "the price-fixing consignment is patently not a security transaction and obviously would not fit easily, if at all, under some of the provisions of Article 9." The 1957 amendment to section 1-201(37) was introduced to "make it clear that a true consignment . . . is not a secured transaction subject to all the filing, priority and enforcement provisions of Article 9." Professor Hawkland notes that:

Clarity would have been promoted if the draftsmen had used language other than 'true consignment,' but the context and the sense of the statement suggest that 'price-fixing consignment' was thereby intended. Such language is often employed in this way, and the price-fixing consignment is the only one which logically should not be 'subject to all the filing, priority and enforcement provisions of Article 9.'

Despite criticism of this functional test, Professor Hawkland has continued to espouse it with the added support of several important court decisions which have adopted the test. Duesenberg questions the source and rationale of Hawkland's test. A consignment (agency, bailment) relationship may be set up not only to permit consignor to fix prices but also, for example, to control the quality of marketing and after-sale services offered by the consignee. He finds nothing mit consignor to fix prices. Mr. Justice Fortas in United States v. Arnold, Schwinn & Co., 388 U.S. 365, 378-79 (1967), emphasizes the distinction between "sale" and "agency":

We conclude that the proper application of § 1 of the Sherman Act to this problem requires differentiation between the situation where the manufacturer parts with title, dominion, or risk with respect to the article, and where he completely retains ownership and risk of loss.

If the manufacturer parts with dominion over his product or transfers risk of loss to another he may not reserve control over its destiny or the conditions of its resale.

Mr. Justice Stewart, concurring in part and dissenting in part, sounds a note of caution:

[The Court's answer makes everything turn on whether the arrangement between a manufacturer and his distributor is denominated a 'sale' or 'agency.' Such a rule ignores and conceals the 'economic and business stuff out of which' a sound answer should be fashioned. . . . Draftsmen may cast business arrangements in different legal molds for purposes of commercial law, but these arrangements may operate identically in terms of economic function and competitive effect. It is the latter factors which are the concern of the antitrust laws.]

Id. at 393.

84. Id.
85. ALI & NCCUSL, SUPPLEMENT No. 1 TO THE 1952 OFFICIAL DRAFT OF TEXT AND COMMENTS OF THE UNIFORM COMMERCIAL CODE 30 supra.
86. Hawkland, supra note 83, at 405.
88. All Duesenberg's writings on consignments cited supra note 82 address themselves specifically to the Hawkland test. See especially Duesenberg supra, note 9, where Duesenberg is highly critical of the decision in Columbia Int'l Corp. v. Kempler, 46 Wis. 2d 550, 175 N.W.2d 465, 7 UCC Rep. Serv. 650 (1970), where the court applied the Hawkland test.
in the Code wording or legislative history which indicates that price-fixing rather than agency relations in general were excluded from the scope of article 9 by the 1957 amendments. Duesenberg points out that many of the article 9 provisions, especially the default rules in part 5, are written for the debtor whose "indebtedness" is secured rather than for the consignee-agent who by definition is not indebted for the price of the goods. On more general policy grounds he argues that Hawkland's distinction will subject so many consignment marketing arrangements to all of article 9's provisions that it will discourage a legitimate marketing device worked out freely by consignor and consignee.

One advantage of the Hawkland test is its simplicity. The general agency test suggested by Duesenberg requires not only careful drafting but also continual policing by consignor for fear that a court, looking at the numerous incidents of an agency relationship, will find that the consignment arrangement is no longer a true agency relationship and, therefore, subject to article 9. By focusing on one incident of the relation between the parties the test proposed by Hawkland allows the parties to determine from the beginning whether their marketing arrangement will be subject to articles 2 or 9.

A test proposed by Professor Gilmore may resolve some of the conflicting considerations raised by Hawkland and Duesenberg. Professor Gilmore suggests that the distinction should turn on whether or not the consignee has the right to return unsold goods. If the consignee is absolutely liable for the price of the "consigned" goods, with no right to return the goods unsold, then the consignor's reserved claim to the goods should be treated as a security interest subject to all the provisions of article 9; otherwise the relevant article 2 provisions should apply. In any case, he rejects a distinction based on the subjective intent of the parties. The Gilmore test, based on the obligation to pay the price with no right to return the goods, conforms more closely to previous usage in doctrine and case law than does the distinction suggested by Hawkland, and this test is nearly as simple as that of Hawkland. Moreover, Gilmore would exclude most consignments from article 9 provisions rather than the reverse, which is what Duesenberg fears the Hawkland

89. Duesenberg, supra note 10, at 237-40. Duesenberg also points out that the parties will be able to bring all consignments within UCC § 2-326 merely by including pro forma a price fixing clause if Hawkland's test is accepted.

90. GILMORE, supra note 73, at 337-40.

91. Id. at 338:

It is clear enough that 'intended' in the provision [sec. 1-201(37)] just quoted has nothing to do with the subjective intention of the parties, or either of them. Under the pre-Code case law on consignments, the dividing line between 'true' and 'false' was drawn with reference to the consignee's right to return unsold goods to the consignor: if he had that right, the transaction was a true consignment; if he became absolutely liable for the price of goods 'consigned' with no right to return unsold goods, the transaction was treated as a security transaction of some sort. The same result will follow under the Code.

92. Most discussion of pre-Code distinctions between a consignment and a sale focus on the obligation to pay the price rather than the right to return the goods, although the latter is also necessary for there not to be a sale. S. WILLISTON, supra note 37, § 338 at 307-08. Professor Williston states: "[I]n the conditional sale, but not in a bailment, the person to whom the goods are delivered enters into an absolute obligation to buy them and pay the price, and, therefore, acquires an immediate property in them subject to the seller's security title."
test would do. Certainly the Gilmore distinction would subject all valid agency relationships to article 2 rather than article 9, and indeed, may go even further than Duesenberg suggests because it would not distinguish the "sale or return" from the agency consignment.93 Section 2-326, however, does not lend itself to such a broad interpretation because it distinguishes the "sale or return" from a transaction "deemed" a sale or return, and only in the case of the latter does section 2-326 provide for publicity and avoidance of the claims of creditors.

Since the Gilmore test strains the construction of section 2-326, one might recast the distinction between "true" and "false" consignment arrangements to focus on whether or not there is an obligation to pay the price of the goods to the consignor at the time of the consignment rather than on the right to return the goods. In the sale or return the buyer is obligated from the time of delivery to pay the agreed price, but in lieu of doing so he may return the goods; if the seller gives credit to the buyer and wishes to secure payment, he should be subject to all the provisions of article 9. If a consignee, however, is not obligated to pay the price of the goods until sale and can return unsold goods, then under this proposed test the consignment would not be intended as security. As to other incidents of the transaction, such as who is to bear the risk of loss, the parties would be free to allocate this cost without worry as to whether a court will later declare the consignment to be intended as security.94 This standard is both simple and consistent with pre-Code case law. If a distinction between "true" and "false" consignments is to be made, the Code should spell out a test for distinguishing the two, and while the test proposed is rough and ready, it does resolve some of the dilemmas posed by Hawkland and Duesenberg.

C. Consignments Under Article 2

Pre-Code consignments were agency or bailment relationships. The transfer of goods from consignor (principal) to consignee (agent) was not pursuant to a contract for sale between these parties: Consignor retained title until consignee sold the goods to a customer, at which time title passed directly from consignor to the customer. Yet an early draft Code text, designed to clarify the status of consignment transactions, spoke of "buyer," "seller," "sale," and "resale."95 Noting this anomaly, the New York Law Revision Commission carefully redrafted the text to refer to the neutral "person making delivery" and "person conducting the business."96 Nevertheless, the official text continues to have anomalies. The caption to section 2-
326 states that the section covers "consignment sales" (emphasis added); a similar reference to "consignment sales" appears in section 1-201(37); paragraph 2 of the official comment to section 2-326, which is unchanged despite redrafting of the text itself, continues to refer to "seller" and "buyer." Nor did the New York Commission text completely avoid the language of "sale": in the second sentence of section 2-326(3) the text refers to "payment or resale." 97

Given the pre-Code law and the legislative history of the Code provisions, it is highly unlikely that the consignment has been transformed into a contract for sale despite the anomalous wording of both Code text and comments. The scope of article 2, according to section 2-102, covers "transactions" in goods unless the context otherwise requires. A "transaction" is a broader category than a "contract for sale." A consignment may be a transaction, and, therefore, subject to article 2, but not a contract for sale. Most sections of article 2 are limited specifically by their wording to the contract for sale, although some important provisions, such as the rules on the good faith purchaser and the prohibition against unconscionable contracts or clauses, are not so limited and will apply to the consignment together with the supplementary general principles of law preserved by section 1-103. Section 2-326(3) only regulates the consignment with respect to claims of consignee's creditors. General principles of agency law will govern the rights and obligations between the parties. 98

The Code amends these general principles of agency law by subjecting consignor's goods to the claims of consignee's creditors, but it permits the consignor to avoid section 2-326(3) by publicizing their relationship. In addition, the parties may avoid subsection (3) by showing that the consignee does not fall within the description set out in the first sentence of that subsection.

Description of Consignee. To bring the transaction within section 2-326(3) consignor must deliver goods to a person "for sale"; this person must "maintain a place of business at which he deals in goods of the kind involved"; and the person must maintain this place of business "under a
name other than the name of the person making delivery." Merchants who sell from inventory in their own name are covered; creditors who finance these merchants' inventory are to be protected from cases where the merchants have ostensible ownership of the goods by taking delivery without taking "title."

An owner of goods, whether a merchant or non-merchant, may deliver them to a person for reasons other than sale. Thus, if goods are delivered to a consignee for repair and storage, with no authority to sell the goods, section 2-326(3) does not apply. If goods are delivered with directions both to repair and to sell them, however, the same subsection will apply.\(^9\) In an important early Code case a consignee who primarily distributed goods to other retailers but who also sold some of the goods was found to be within the scope of subsection (3).\(^{100}\) Another court has stated that even if the consignee had no authority to sell goods and merely delivered goods to other retailers for sale, the court would still subject the goods to the claims of consignee's creditors in order to carry out the policy of section 2-326 unless consignor met the publicity requirements set out in subsection (3).\(^{101}\) Where a supplier "consigned" goods to a subcontractor in financial difficulties who used the goods for its jobs and charged a lump sum for both services and goods, the court brushed aside the suggestion that the goods consigned were not consigned for sale, noting that the cost of the goods represented a distinct, identifiable part of the price charged by the subcontractor.\(^{102}\)

The courts have read broadly the requirement that the goods be delivered for sale. The test itself is unfortunate in that it turns on the express authority given consignee by consignor, about which third parties will not know unless they inquire, whereas the other tests (dealing in similar goods, under a name other than consignor's) are ones which will be readily apparent to creditors. Purchasers in the ordinary course of business from the consignee are

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9. Consignor in *In re International Mobile Homes*, 14 UCC Rep. Serv. 1150 (E.D. Tenn. 1974), argued that it had consigned repossessed mobile homes for repair and storage, giving consignee no authority to sell. The court found no evidence to support this argument but implied that if there had been proof of limited authority in consignee the transaction would not be subject to UCC § 2-326(3). A similar argument was advanced in *Blowers v. First Nat'l Bank*, 45 Ala. App. 485, 232 So. 2d 666, 7 UCC Rep. Serv. 668 (1970). Consignor, a car rental agency, argued that it had left the vehicles in dispute with the consignee for repairs. The Alabama court found that there was sufficient evidence to support the trial court's determination that there had been a consignment for sale. In *American Nat'l Bank v. Etter*, 28 Colo. App. 511, 476 P.2d 287, 8 UCC Rep. Serv. 298 (1970), the court found that the repairs were only incidental to resale. See also *American Nat'l Bank v. Tina Marie Homes, Inc.*, 28 Colo. App. 477, 476 P.2d 573, 8 UCC Rep. Serv. 281 (1970).

Should the casual non-merchant who leaves his car at the corner service station to see if a mechanic can sell the car be subject to § 2-326(3)? Without elaboration the court in *Allgeier v. Campisi*, 117 Ga. App. 105, 159 S.E.2d 458, 5 UCC Rep. Serv. 93 (1968), protected the non-merchant consignor by finding that consignee was authorized only to solicit offers to purchase and not to sell. The case is noted in *Vonins, Inc. v. Raff*, 101 N.J. Super. 172, 243 A.2d 836, 5 UCC Rep. Serv. 433 (1968).


protected by section 2-403(2). Creditors, on the other hand, will have to inquire into the authority of the consignee with respect to goods in his possession in order to protect themselves fully even if the notoriety provisions in subsection (3) are met.

Consignee must maintain a place of business at which he deals in goods of the kind involved in order to fall within the scope of section 2-326(3). In an early leading case, consignee had goods marked with its name and forwarded directly to department stores whose employees sold them. Consignee received a commission for arranging these retail outlets. The New York courts found that consignee did not maintain a place of business at which it dealt in these goods. That the consignee "deals" in the goods without necessarily selling them at his place of business brings within the scope of subsection (3) more than the retail merchant. Thus, a court has found that a transaction involving a subcontractor who maintained a place of business but did not make retail sales from this office to be within subsection (3). Similarly, "goods of the kind involved" is an elastic term. A retailer of floor coverings who took a consignment of expensive oriental rugs was found to be dealing in similar goods (floor coverings) without inquiring whether or not creditors would be misled. Finally, consignee must maintain a place of business at which he deals in goods of the kind involved "under a name other than the name of the [consignor]." There is ambiguity as to whether this clause modifies "maintaining the business" or "dealing": i.e., must consignor's name appear over the door or on all business papers, or both? The policy of protecting creditors from relying on ostensible ownership suggests that for consignee to fall outside section 2-326(3) all indications should warn of the consignment arrangement. However, in response to an oil company's argument based on the fact that the company's trade name appeared prominently outside a service station at which the company "consigned" gasoline, a court in a recent decision noted that the name of the service station "dealer" also appeared

103. UCC § 2-326(3) uses both "maintain" a place of business and "conduct" the business. No one has questioned that the person who maintains a place of business is the same person who conducts the business, but in an appropriate case a distinction might be made.

104. *In re Mincow Bag Co.*, 53 Misc. 2d 599, 279 N.Y.S.2d 306, 4 UCC Rep.Serv. 197 (Sup. Ct. 1967), aff'd, 29 App. Div. 2d 400, 288 N.Y.S.2d 364, 5 UCC Rep. Serv. 60 (1968), aff'd *per curiam*, 24 N.Y.2d 776, 248 N.E.2d 26, 300 N.Y.S.2d 115, 6 UCC Rep. Serv. 112 (1969). A well-argued dissent in the appellate division suggests that consignee's creditors would have understood that the department stores were places at which consignee dealt. "Ingenuity can devise any number of variations of the consignment or sale or return agreement which take the transaction out of the letter of the law, but not out of its spirit . . . . It is the latter that should control interpretation." 29 App. Div. 2d at 403, 288 N.Y.S.2d at 367, 5 UCC Rep. Serv. at 62. Certainly the decision permits consignor and consignee to avoid the claims of consignee's creditors under UCC § 2-326 by having shipper deliver directly to consignee's customers. The language of § 2-326(2) and (3) appear, however, to compel the majority's decision. Under subsection (2) the goods are only subject to consignee's creditors' claims while the goods are in his "possession."


over the door and that creditors might rely on this indication that the dealer was the real owner of the gasoline.\footnote{107}

Courts generally have had little difficulty rejecting arguments that consignee or “person taking delivery” was not within the definition of the first sentence of section 2-326(3). At least one court has stated that its broad interpretation was based on the policy of protecting creditors from relying on the apparent ownership of the consignee.\footnote{108} At the same time, too broad an interpretation may vitiate inoffensive distribution techniques used by consignors who will not consider the consignment as within the sales or the secured transaction provisions of the Code. For example, a wholesaler may wish to give consignee no power to sell but to use him as an independent distributor to specific retailers because consignee has warehouse and shipping facilities in a strategic location. The thrust of the decisions would include this distribution technique but not one where consignee never had possession of the goods, having arranged with manufacturer to send them directly to retailers.

Sign Law. Consignor may take the arrangement out of the provisions of section 2-326(3) by complying “with an applicable law providing for a consignor's interest or the like to be evidence by a sign” as provided in section 2-326(3)(a). The draftsmen apparently contemplated the so-called “Traders' Acts” of which the Virginia statute was most well-known.\footnote{109} Only North Carolina and Mississippi, however, continue to have these Acts on their statute books.\footnote{110} West Virginia repealed its provision with the enactment of the Code in 1963, and Virginia finally repealed its provision in 1973.\footnote{111}

One might conclude that the sign law “way out” for the consignor is a virtual dead letter. Several courts have implied, however, that subsection (3)(a) refers not only to statutory law but also to common law, and even that the provision permits labels on the goods indicating consignor's claims to take the consigned goods from the reach of consignee's creditors. After noting that New Jersey has no sign statute, a New Jersey court went on, however, to note that consignor had not even placed a sign on the consigned merchandise indicating his claim.\footnote{112} More recently, a federal court in Arizona noted that that state had neither statute nor court rule permitting consignor to protect his interest by a sign and that in any case consignor had


\footnote{108. After initial hesitation, the Pennsylvania courts ruled that the reference was to a statute and most later courts have agreed. In re Downtown Drug Store, Inc., 3 UCC Rep. Serv. 27 (E.D. Pa. 1965); In re Levy, 3 UCC Rep. Serv. 291, 292 (E.D. Pa. 1965) (“The phrase ‘an applicable law’ as used in Section 2-326(3)(a) of the Code means a statute.”).}

\footnote{109. See VA. CODE ANN. tit. 8, § 55-152 (repealed 1973).}

\footnote{110. N.C. COMM. & BUS. CODE § 66-72 (1975); MISS. CODE ANN. § 15-3-7 (1972).}

\footnote{111. W. VA. CODE ANN. ch. 47, § 47-8-1 (repealed 1963); VA. CODE ANN. tit. 8, § 55-152 (repealed 1973).}

not labeled his goods.\textsuperscript{113} If these decisions are followed, however, creditors would be required actively to police their debtors and the goods on their premises. The creditors could not rely on the absence of notice in a public file or on the general reputation of their debtor. Doubt as to how explicit the label would have to be also suggests that the rights of parties would always be uncertain.

Subsection (3)(a) has outlived its usefulness and remains only to confuse. One reason filing under article 9 was introduced in subsection (3)(c) was to enact a sign law for states which did not already have a Traders’ Act.\textsuperscript{114} Only two states continue to have such statutes. California decided not to include the provision when it enacted section 2-326. If the consignment rules are revised this subsection should be discarded.

**Consignee Known To Deal in Consigned Goods.** Consignor may also avoid section 2-326(3) by establishing that consignee is “generally known by his creditors to be substantially engaged in selling the goods of others” (section 2-326(3)(b). The hope this provision offers is illusory. In all but one of the reported cases, consignors who have relied on it in order to avoid the claims of consignee’s creditors have failed. Perhaps success in an early case raised consignors’ hopes. Consignee operated a furniture cleaning enterprise and sold new and used furniture as well. A non-merchant consumer left used furniture with consignee to sell. A window sign advertised both used and new furniture and the court held that this sign, coupled with the absence of any new furniture on the premises, gave notice that consignee dealt in the goods of others.\textsuperscript{115}

Consignors in subsequent cases have put on progressively more elaborate cases. A lower court decision which found in a series of related cases that debtor-consignee was generally known by his creditors to sell goods on consignment was overruled on the ground that there was insufficient evidence.\textsuperscript{116} In an earlier case another court had ruled that evidence showing that ten trade creditors knew of the consignment was insufficient given that fifty-five to sixty general creditors did not know.\textsuperscript{117} A general newspaper advertisement announcing the arrival of a consignment of oriental rugs was held inadequate, and evidence that oriental rug dealers always dealt “on consignment” was found insufficient to show that creditors of the consignee knew of the consignment in that case. The same court also found as a fact that the consignee was not substantially engaged in selling the goods of others.\textsuperscript{118} A more recent decision sets out an elaborate analysis of subsection (3)(b). After citing dictionary definitions of “generally” and “substantially,”

\begin{itemize}
  \item \textsuperscript{113} Interstate Tire Co. v. United States, 12 UCC Rep. Serv. 948 (D. Ariz. 1973).
  \item \textsuperscript{114} Hearing, supra note 1, at 193.
  \item \textsuperscript{115} In re Griffin, 1 UCC Rep. Serv. 492 (W.D. Pa. 1960).
  \item \textsuperscript{118} In re Fabers, Inc., 12 UCC Rep. Serv. 126 (D. Conn. 1972).
\end{itemize}
the court said that consignor must show that "most of the bankrupt's (consignee's) creditors knew that a considerable amount of the bankrupt's business was selling the goods of others." Although seventy-six unsecured and eight secured creditors had been scheduled, testimony showed that only fifteen creditors knew that consignee was selling the goods of others. In response to the argument that the fifteen creditors represented over one-half of the total scheduled claims, the court noted that section 2-326(3) "clearly does not speak of the amount of indebtedness but to 'creditors.'" The court also noted bankrupt's testimony that consignor's goods represented only "a very small portion of business."  

In another bankruptcy proceeding, a consignor seeking to reclaim goods from his bankrupt consignee's assignee presented the testimony of a series of officials from local bank and credit institutions. After reviewing the testimony the court noted that although most witnesses were familiar with bankrupt's manner of doing business, they neither represented creditors of bankrupt nor had they spoken with bankrupt's creditors about his business. Of the fifteen unsecured and three secured creditors scheduled only two testified about their knowledge of bankrupt's business methods and the court found this insufficient to meet the test of section 2-326(3)(b).

Section 2-326(3)(b) is a remedial device rather than a planning provision. No merchant consignor with the alternative of either filing under article 9 pursuant to section 2-326(3)(c) or relying on subsection (3)(b) would choose the latter. Even if at the time of the consignment consignee was generally known by his creditors to be substantially engaged in selling consigned goods, consignee's business might change and his creditors turn over. Potential creditors will be in a similar dilemma because they will have to decide whether or not consignee meets the same test and they will have to police their debtor to ensure that he does not change the conduct of his business. On the other hand, a non-merchant consignor, who is unlikely to know about filing under article 9 or to understand that "his" goods may be taken by consignee's creditors, may be able to prevail under subsection (3)(b). Given the inherent uncertainty embodied in the flexible wording of subsection (3)(b) and the difficulty of meeting the test, perhaps it should be abandoned, at least with respect to merchant consignors. Merchants are now familiar with the simple and uniform filing scheme provided under article 9 and the burden of filing is not great.

**Filing Under Article 9.** If consignor "complies with the filing provision of [Article 9]" section 2-326(3)(c) provides that his goods in the hands of consignee will not be subject to the claims of consignee's creditors.

Despite its apparent innocuousness this provision does raise several

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120. *In re International Mobile Homes*, 14 UCC Rep. Serv. 1150 (E.D. Tenn. 1974). None of the court decisions has made anything of the use of the word "known" in UCC § 2-326(3)(b). *Id.* § 1-201(25) notes that "A person 'knows' or has 'knowledge' of a fact when he has actual knowledge of it." Consignor apparently must produce evidence of actual knowledge by a majority of consignee's creditors, although the adjective "generally" may suggest a less rigorous standard (i.e., than the context otherwise requires).
problems. Two have already been discussed: the absence of a time limit for filing and the applicability of article 9 non-filing provisions to a "true" consignment.\textsuperscript{121} A third problem is whether a "true" consignor is ever \textit{required} to file under article 9.

Section 2-326(3) offers consignor several options if he wishes to free his goods from the claims of consignee's creditors: he may comply with a sign law or he may establish consignee is known as such by most of his creditors. The first option is permitted in only two states and the second may leave uncertain the rights of the parties; nevertheless, these options are available. The alternative of showing notoriety, moreover, is available to the consignor at the time creditors seek to enforce their claims against the goods so that this option will be open to consignor even after he delivers the goods to the consignee. Furthermore, the consignor always has the option to do nothing.

Given the wording of section 2-326(3), it comes as a surprise that the 1972 Code amendments and official comments thereto refer to the "requirement" of filing. Section 9-114(1) addresses itself to a consignor "who would be required to file under this Article by paragraph (3)(c) of Section 2-326." The official comment to that section also speaks of this "requirement," as does the reason given for the adoption of section 9-408. Perhaps the draftsmen had in mind the consignor in a state with no sign law who knows that consignee is not substantially engaged in the selling of goods of others so that, as a practical matter, if he wishes to protect the goods from the claims of his consignee's creditors, he will have to file. The language of the official comment to section 9-114, however, is more sweeping and it seems to assume most assignments will be covered by that section. As a matter of policy it may be desirable to require all merchant consignors not only to file under article 9 but also to notify prior inventory secured parties. The present Code, however, does not do the former and consequently it leaves the latter result in doubt.

\textit{Estoppel or Related Theory.} Is it still possible for consignor to prevail over a creditor of his consignee even though consignor has not complied with section 2-326(3) notoriety provisions if consignor can show that the creditor himself knew about the consignment arrangement? The structure of section 2-326(3)—first subjecting all consigned goods to the claims of consignee's creditors and then setting out specific ways of avoiding these claims—militates towards concluding that the notoriety provisions are exclusive and that an estoppel argument should be rejected. Several consignors, however, have made estoppel-like arguments, so far without success.

In one case consignor argued that a creditor was estopped to assert its claim because of its method of dealing and its failure to ascertain the true status of title. The appellate court rejected this argument, noting that "where a legal right is clearly established, the equitable doctrine of estoppel can not be used to circumscribe that right." The court also noted that consignee's

\textsuperscript{121} See notes 55-80 \textit{supra} and accompanying text.
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creditor has made no representation upon which consignor had relied to his
detriment.\textsuperscript{122}

In another case, decided under a statute adopting the 1962 official text, purchaser bought from bankrupt-consignee's receiver. Purchaser knew that consignor had consigned goods to the consignee. The court found that the receiver was a lien creditor without knowledge because there was no allegation that all of consignee's creditors knew of consignor's arrangement as required by section 9-301(3). Receiver, therefore, prevailed over consignor under section 9-301(1)(b) and the purchaser from the receiver stepped into receiver's shoes without regard to purchaser's knowledge of the consignor's marketing arrangement. While the decision relates to a special case of an intervening receiver, the implication is that "true" consignments may be unperfected security interests subject to section 9-301 and that consignor will prevail over lien creditors with knowledge of his interest in the consigned goods.\textsuperscript{123} On this point the court's reasoning is questionable. I have suggested earlier that non-filing provisions of article 9 are not applicable to the "true" consignment. In any case, the court's construction will be unavailable in states which have adopted the 1972 official text of the Code because that text deletes the requirement in section 9-301(1)(b) that the person who becomes a lien creditor before the security interest is perfected be "without knowledge."

\textbf{III. Conclusion}

The "true" consignment marketing device is neither fish nor fowl. It is not a "sale" because consignor retains extensive control over the goods, consignee is not obligated to pay a fixed price, and consignee may return the goods at any time. Consignor does, however, give up possession of the goods with the intention of having them sold to third parties. Yet consignor wishes to retain control over the goods after they leave his possession. Traditionally he has been able to do so by establishing an "agency" relationship with consignee whereby consignor had control over the activities of the consignee and continued claims to the goods. This control and these claims were recognized as distinct and more extensive than the security interest retained by seller to secure payment of the purchase price. When legislation required security interests in personal property to be recorded in public files, merchants used the consignment as a "disguised" security device. Courts have tried to distinguish the "true" from the "false" consignment, and after initial attempts to apply article 9 to all consignments, the draftsmen of the Uniform Commercial Code have tried to do likewise.\textsuperscript{124}


\textsuperscript{124} The Code draftsmen have not been alone in trying to legislate for the consignment. The Model Uniform Personal Property Security Act adopted by the Canadian Bar Association in September 1970 tried to do likewise: This recommendation was made because in practice it is often difficult to distinguish between a consignment agreement or a lease which is a disguised security agreement and one which is not and because, so far as
The Code provisions raise problems which court decisions and commentators have not yet resolved. In this Article I have suggested some solutions and some possible amendments. On the whole, I question whether the distinction between "true" and "false" consignments is necessary, especially if one excludes from the scope of the Code casual non-merchant consignments. If article 9 were to govern all consignments, the freedom of the consignor to fix the terms of his marketing arrangement would be restricted, especially by the default provisions. But is this so dreadful? If there is to be a distinction, however, the test for making this distinction should be defined further by the Code. A proposed test which draws on accepted past distinctions would be whether or not the consignee is obligated from the time of delivery to pay the price and whether or not he may return the goods at any time. More specifically, if section 2-326(3) is to be retained, I suggest that paragraphs (a) and (b) be deleted and consignor be required to file within a given time under article 9 in order to avoid the claims of consignee's creditors. The Code's consignment provisions are due for a consistent overhaul to eliminate anomalous cases and to clarify the rights of the parties.