ORPHANED ART CONSIGNORS: CONFUSION IN THE COURTS AND THE UCC♦

INTRODUCTION

A consignment is a transaction in which an owner of goods (the consignor) delivers the goods to a consignee for the limited purposes of sale.[1] In a consignment, the consignor delivers possession of the consigned goods, as well as the power of sale.[2] Should the consignee succeed in selling the consigned goods, the consignee transfers to the consignor the sales proceeds, less a fee or commission.[3]

The consignment transaction is a popular means by which artists, collectors, and other individuals sell their art. The law governing the rights of the consignor vis-à-vis the consignee is generally well settled,[4] but consignees often have secured or unsecured creditors who may seek to collect property in the consignee's possession to satisfy default of payment. In such a circumstance, the artist's or the collector's artworks may be in the consignee's possession, making the creditor a competing claimant to the artist's or collector's consigned art. The rights of consignors vis-à-vis the consignee's unsecured and secured creditors, however, lacks clarity, and the recent revisions to the Uniform Commercial Code ("UCC" or "Code") have produced unfair results for consignors in the art market. For example, if an artist or collector produces or owns a work (1) for non-commercial purposes, or (2) the work is worth less than $1000, or (3) the work is consigned to a dealer and the dealer's creditors might know that the dealer sells consigned works, then the UCC arguably affords the artist or collector less protection than where these three circumstances are otherwise—the work is sold for commercial purposes, worth more than $1000, or the dealer's creditors know that the dealer sells consigned goods.

In light of the uniqueness of the "art market, the competing provisions in statutes and the UCC have left courts in a legal morass.[5] This Note argues that the 2001 revision of the UCC has a serious drafting error, or at least an unintended consequence from a lack of specific statutory language, which has led courts to afford consignors of art fewer protections than the pre-2001 UCC and ignores the realities underlying consignment transactions in the art market. Indeed, this unfavorable result for art consignors

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1 *See* 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 3.5, at 73 (1965).
2 *Id.* at 73–74.
3 *Id.*
4 *See* Mark Marcone, Note, *The UCC and Consignment: Making the Code Safe for Artists and Other "Little Fellows,"* 12 CARDOZO ARTS & ENT. L.J. 579, 580 (1994).
5 *See, e.g.*, *In re* Morgansen's LTD, 302 B.R. 784, 787 (Bankr. E.D.N.Y. 2003) (holding that "if the transaction does not fit under section 2-326, then the transaction falls entirely outside the Uniform Commercial Code, and the Court must then fall back on the common law of bailments . . ."); *see also In re* G.S. Distrib., Inc., 331 B.R. 552, 561 (Bankr. S.D.N.Y. 2005).

is unintended and contrary to the purposes of the 2001 revisions.

In Parts I and II, I provide a brief background to the law of consignments, as it is developed in the common law and later codified in the UCC. In Parts III and IV, I address the shortcomings of the pre-2001 Code that culminated in the 2001 revisions to Articles 2 and 9. In Part V, I describe the purposes for the 2001 revisions as well as the provisions in the Revised UCC relevant to consignments of art. In Part VI, I argue that the 2001 revisions to the UCC have unintentionally left many consignors of art worse off than they were before the revisions, and that this runs counter to the intent of the UCC's drafting committee. Part VII proposes revisions to the UCC that balance the culture of the artists and other art consignors against the interest in protecting creditors from "hidden liens."[6]

I. BACKGROUND

A. *Possession: A Proxy for Ownership?*

The UCC and the common law have long sought to define the rights of consignors vis-à-vis the consignee's creditors.[7] Commonly litigated is the extent to which either the consignee's creditor(s) or the consignor—or even art-transferor that is not a consignor—should bear the risk of a consignee's insolvency.[8] The consignor usually expects her consigned work to be returned to him if and when the consignee becomes insolvent, cannot sell the art, or files for bankruptcy—after all, the consignor still owns the art.[9] The consignee's creditors, however, generally expect that the property (including the consigned art) in the debtor's possession is owned by the debtor-consignee; thus, the property should be subject to the creditors' claims in satisfaction of nonpayment.[10] The creditor, absent notice, will not expect that the property in the debtor-consignee's possession is actually property *owned* by an unknown consignor.[11] The creditor, moreover, will often

6 *See infra* note 14 and accompanying text (discussing the concept of "hidden liens").
7 *See* GILMORE, *supra* note 1, at 62–85 (discussing the pre-Uniform Commercial Code history and development of creditor rights relating to consigned goods).
8 *See, e.g.*, *In re Morgansen's*, 302 B.R. 784 (holding that if a consignment is not an Article 9 consignment, then the court will see if the consignment constitutes a "sale or return" under section 2-326 and if not, then the court must analyze the transaction under the common law of bailments); *see also In re* G.S. Distrib., Inc., 331 B.R. at 561.
9 This is the "common-sense" result because "true consignments" provide that the consignor retains *title*, but not possession of, the goods. *See* GILMORE, *supra* note 1, § 3.5, at 73. Accordingly, the legally unsophisticated consignor would expect to either receive the goods or payment from sale of the goods.
10 *See id.* at 74–75 (discussing how creditors rely on goods in the debtor's [consignee's] possession as inventory, and absent notice to the contrary, the creditors expect that all inventory is subject to the secured creditors' claims).
11 *See id.*

determine how much, and under what conditions, it will lend to the debtor-consignee based upon the debtor's finances *and the value of property in possession of the debtor.*[12] Accordingly, the UCC seeks to protect third-party creditors against "hidden liens" on the debtor's property.[13] A "hidden lien" arises when property in the hands of the debtor, to which the debtor does not have title, is beyond the reach of the debtor's creditors with the additional fact that such property is not secured by a financing statement to provide the creditor notice of the "lien."[14]

The operative effect of protecting creditors from such "hidden liens" manifested itself in the pre-2001 UCC, which, absent notice to the debtor-consignee's creditors, generally subverted the artist's or art owner's interest in consigned works to the right of the creditor to take the works free of the owner's interest.[15] Although protecting unsuspecting creditors from "hidden" interests or liens is a well-settled underlying principle in United States statutory and common law,[16] protecting creditors at the expense of independent artists, collectors, or hobbyists makes little sense in the context of the art market.[17]

B. *The "Uniqueness" of the Art Market*

Because commentators often characterize consignments as "hidden liens," the legal fictions that simplify a consignor's rights in a consignment transaction do not take into account the realities of the art market.[18] Scholars and economists agree that the art market is comprised of a "handshake" culture in which artists and

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12 *See* Douglas G. Baird & Thomas H. Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175, 183–84 (1983) ("A secured creditor can determine if there are competing claims to his collateral by examining both the property that the debtor possesses and the public filings."). For example, a bank may lend money to an art gallery that is in the business of selling and displaying works of art. Not all of the artworks may be for sale; some of the artworks may simply be on display in order to market other artists or simply fill wall-space. A lender may loan money to the gallery in order to finance the gallery's renovation of certain floors, but in exchange for the loan, the debtor may agree to secure the loan with the debtor's inventory. Absent notice to the creditor that some of the "inventory" is actually not inventory, but simply works on display from independent consignors, the creditor will make the loan with the expectation that the debtor's entire inventory is secured as collateral to the agreement.

13 Cantor v. Anderson, 639 F. Supp. 364, 369 (S.D.N.Y. 1986) ("The purpose of U.C.C. § 2-326 is to protect creditors of a consignee of goods from hidden liens."); *see also infra* note 18 and accompanying text for a discussion of "hidden liens."

14 *See, e.g.*, Recent Development, *Commercial Transactions: UCC Section 2-326 and Creditor's Rights to Consigned Goods*, 65 COLUM. L. REV. 547, 548 (1965).

15 *See* Marcone, *supra* note 4, at 580 ("[W]hen the ownership interest of a consignor is not signalled to creditors, the consignor's interest in the goods is directly subverted to a secured creditor's interest in the goods . . . .").

16 *See* GILMORE, *supra* note 1, § 3.5, at 73–75.

17 *See* Marcone, *supra* note 4, at 580–81 (discussing the uniqueness of consignments in the art market).

18 *See infra* notes 22–25 and accompanying text (discussing how the "uniqueness" of the art market is at odds with requisite legal formalities when consignors seek to protect their interests in consigned goods).

collectors often rely on trust, rather than executed writings, to build and establish relationships with consignee-dealers.[19] The most important executed writing is the UCC financing statement, which artists and dealers can both file. If the artist or dealer files a UCC financing statement, then the consignment transaction is automatically protected against the claims of the dealer-consignee's creditors.[20] Yet, some scholars suggest that legal formalities, such as the UCC financing statement, would insult the "uniqueness" of the artist-dealer relationship and lead to distrust between the consignor and the consignee.[21]

The art market is "unique" because it operates primarily on "trust and relationships."[22] Artists and dealers alike do not file financing statements not simply because of an unenlightened view that artists and dealers may lack *legal* sophistication; rather, they do not file financing statements because of the consanguineous depth of their trust. Logically, then, without trust, an art consignment agreement would be unlikely. To illustrate the depth of trust in the art market, consider one art dealer's pithy summary of the art market's "uniqueness":

> Anyone [sic] tries to take precautions in this business, it's offensive to someone. Someone not too long ago wanted us to show a painting to a client of ours. And they [sic] wanted us to sign a UCC filing. *As if we were a debtor!*[23]

The same art dealer, upon being requested to file a UCC financing statement, initially refused the deal, finding even a request for filing to be "very offensive."[24] Naturally, this "handshake culture" embraces trust over formality, and even though filing a UCC financing statement may seem like a typical business precaution in non-art markets, the art world finds the topic of legal formalities—specifically UCC financing statements—

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19 *Cf.* 1 RALPH E. LERNER & JUDITH BRESLER, ART LAW: THE GUIDE FOR COLLECTORS, INVESTORS, DEALERS, AND ARTISTS 3 (2d ed. 1998) (describing the artist-dealer relationship as one built on a "handshake").

20 *See* U.C.C. §§ 9-103(d), 324.

21 *See* LERNER & BRESLER, *supra* note 19, at 7 ("[A]rtists in general and many dealers believe that to memorialize their agreements in writing would constitute an insult to the uniqueness of the artist-dealer relationship . . . .").

22 Paul Sullivan, *Protect Your Art With More Than a Handshake*, N.Y. TIMES, Apr. 10, 2010, at B6, *available at* http://www.nytimes.com/2010/04/03/your-money/home-insurance/03wealth.htm ("[The art market is] a market that tends to operate on trust and relationships.").

23 Anthony Haden-Guest, *Art Scandal: Art World Shake-Up?*, FORBES.COM, www.forbes.com/2001/02/14/0213artfraud4.htm (last visited Oct. 7, 2011).

24 *See id.* (Refering to a situation where art brokers wanted him to sign a UCC filing before she took the painting as a consignment, one art dealer said "I found it very offensive. I refused, I raised hell and finally Frances here said, 'Come on, we've got a client for it! Sign it!' If it was someone here that knew me, obviously I would really be pissed off . . . .").

"highly awkward" and insulting.[25]

The drafters of the UCC ignored—or at least disregarded—the "uniqueness" of the art-consignment culture when attempting to balance the rights of consignors against those of creditors, and many states have passed laws in order to offer artists and collectors more protection.[26] However, there were often points of tension for courts in deciding whether the UCC or a state statute that purports to offer greater protection to consignors of art than the UCC is controlling in protecting the art consignor.[27] Much of this tension is the result of UCC section 1-104, which states, "no part of [the UCC] shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided."[28] Therefore, where an artist-protection statute was passed after a state's adoption of the UCC, the UCC would still control—assuming the two statutes conflicted—unless the subsequent statute expressly repealed conflicting provisions of the UCC. Usually, however, the statutes that seek to afford art-consignors greater protection were passed before UCC section 1-104 came into existence, thereby creating a conflict between principles of statutory interpretation for courts that sought to reconcile the competing definitions and protections between the statutes and the UCC.[29]

The UCC drafting committee in 2001 attempted to ameliorate the "hidden lien" problem of the pre-2001 version, seeking to clarify the rights of consignors against third party creditors and to offer consignors more protection. The 2001 revision, however, substantially harms artists and collectors to an even greater degree than the pre-2001 UCC in what may be classified as a drafting error. In order to understand the problems for art consignors, one must understand the history and development of the law of consignments.

II. BRIEF HISTORY AND DEVELOPMENT OF "CONSIGNMENT"

Before the UCC, adopted widely by states in the mid-1960s, the common law governed consignments under principles of bailment.[30] A bailment is a transfer of possession, but not of title,

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[25] Suzanna Andrews, *The Art of Steal*, PORTFOLIO.COM (Mar. 17, 2008), http://www.portfolio.com/culture-lifestyle/culture-inc/arts/2008/03/17/Art-Dealer-Larry-Salander-Trials/index7.htm ("The dealer Richard Feigen notes, however, that for many in the art world, filing a U.C.C. 'would be highly awkward, really almost an insult.'").
[26] *See infra* notes 97–106 (listing and discussing a few statutes that seek to provide more protection to the artist than the protection the UCC provides to the artist).
[27] *See* Marcone, *supra* note 4, at 580–81.
[28] U.C.C. § 1-104 (1990) (current as of 2011).
[29] *See infra* notes 107–17 (discussing the conflict as to whether the UCC or a relevant statute governs the rights of the artist vis-à-vis the consignee's creditors).
[30] *See* Marcone, *supra* note 4, at 592–93 (discussing the UCC's common law roots in

to someone for a specific purpose.[31] An everyday type of bailment is the coat-check: you check your coat; the establishment has possession, but not title, of the coat; the specific purpose of the transfer is to hold the coat for a period of time; and finally the coat must be returned to you. Similarly, a consignment is a form of bailment. But, unlike the coat-check bailment, where the specific purpose is to hold the coat for a period of time, the consignment-bailment's specific purpose is usually for the bailee to sell the art—or simply display the art—on the bailor's behalf.[32] Notably, the bailor retains title and only transfers possession of the bailed (consigned) art. The bailee's lack of title is significant in determining the rights of the bailor against those of the bailee's creditors; a bailee's creditors, even if they are secured creditors, cannot attach a security interest in bailed goods.[33] Because of creditors' inability to attach a security interest in bailed goods, the bailor's ownership interest in the goods is protected against the bailee's creditors. For example, in an art bailment (consignment), the bailor would have the right to retrieve the bailed artwork from either the bailee or the bailee's creditors. The bailor's supreme rights in the bailed goods remained even in the absence of notice of bailed goods to the bailee's secured creditors.[34]

As a subset of the common law of bailments, the common law of consignments did not focus on whether a consignee's creditors had notice of consigned goods.[35] Instead, in determining the rights of consignors against those of the consignee's creditors, courts would focus on whether the transferor and transferee mutually intended title to pass along with possession.[36] The purpose of focusing on whether the parties intended transfer of title was to protect an owner's (the consignor's) property rights in the consigned goods.[37] If an owner of goods transferred

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principles of bailment as applied to consignments).

31 BLACK'S LAW DICTIONARY 151 (8th ed. 2004) ("A delivery of personal property by one person (the *bailor*) to another (the *bailee*) who holds the property for a certain purpose under an express or implied-in-fact contract.").

32 *See, e.g.*, Margit Livingston, *Certainty, Efficiency, and Realism: Rights in Collateral Under Article 9 of the Uniform Commercial Code*, 73 N.C. L. REV. 115, 130 (1994) (discussing "true" consignments as one form of bailment, as well as other bailments).

33 *See, e.g.*, *In re* Zwagerman, 125 B.R. 486 (Bankr. W.D. Mich. 1991).

34 *See* Marcone, *supra* note 4, at 593–94 (discussing the rights of consignor vis-à-vis creditors of the consignee under principles of bailment).

35 *See id.* at 582–83.

36 *See, e.g.*, Consol. Accessories Corp. v. Franchise Tax Bd., 161 Cal. App. 3d 1036, 1040 (Cal. Ct. App. 1984) ("If . . . the parties to the transaction intend passage of title, the transaction may be regarded as a contract of sale rather than a bailment. In determining which event occurred, bailment or contract of sale, the intent of the parties is controlling.") (citation omitted).

37 *See* GILMORE, *supra* note 1, §3.5, at 73–75 (discussing how in true consignments, the consignor does not intend to pass title until the goods are purchased, but in consignments intended as security, the consignor actually intends passage of title, which in turn qualifies the latter consignment as not truly a consignment, but a transfer of goods

possession, but did not transfer title, then any subsequent transfer of the owner's title without the owner's permission might operate as a theft.[38]

The purpose of focusing on the parties' intention of whether title passed was to protect creditors from secret liens.[39] Creditors, when lending to debtors, often rely on the debtor's property to determine the extent, if any, to which a creditor will finance the debtor's activities.[40] If a transferor, such as a consignor, and a transferee, such as a consignee, intend a transaction to transfer title to the debtor-consignee, whether or not such title actually passed to the transferee, then there is likely no reason for the transferor to have rights against the transferee-debtor's creditors because the transferor no longer has an intended title-interest in the transferred property. On the other hand, if the transferor and transferee intend the transferor to retain title, then there is often no reason to disregard the transferor's title-interest in the transferred goods for the sake of satisfying a disgruntled creditor; this is because the creditor can only reach the property of the *debtor*, not the debtor's consignor.

Generally, courts found an intent to transfer title when the transferor and transferee intended a sale between them or, alternatively, intended a transfer of goods to act as security for payment of their price.[41] The former (intending a sale) was an actual transfer of title, relinquishing the transferor's remaining title-interest in the goods; the latter (intending a security) was characterized as an intent to create a security interest in the transferred goods, essentially establishing the transferor as an unsecured creditor. Thus, If the parties to a purported consignment intended to create a security interest, then the secured creditor likely would have prevailed because the parties would not have provided the transferor's creditors with notice of the security; the result of the lack of notice was the creation of a "hidden lien" or "hidden security," which resulted in unfairness to creditors that relied on notice of other liens and interests on the debtor's property. Ultimately, the Supreme Court in *Ludvigh v. American Woolen Co.* ruled that in true consignments—those consignments wherein the parties do not intend a transfer of title

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for which the transferor retains a security interest).

38 This conclusion is deduced from the fact that absent specific statutory protection to the contrary, the consignor who did not intend to transfer title should not be classified as an unsecured creditor because goods in a "true consignment" should not be subject to the claims of the consignee's creditors. *See id.*

39 *See, e.g.*, Peek v. Heim, 17 A. 984, 985 (Pa. 1889).

40 *See* Marcone, *supra* note 4, at 580 (discussing how under the Ostensible Ownership doctrine, a secured creditor may rely on the debtor's possession of goods as evidence of ownership).

41 *See Peek*, 17 A. at 985.

to the consignee/transferee—the consignee has no interest in the consigned goods because the consignor retains title.[42] The result, then, was that even in the absence of notice to a transferee's creditors of consigned goods, the creditor's reliance on the possessions of the debtor did not matter.

Subsequent courts, influenced by principles of equity and a concern for protecting creditors' rights, identified nuances in "consignment" transactions in order to avoid the consignor-friendly *Ludvigh* rule.[43] One such nuance was that to be a "true consignment," the relationship between the consignor and consignee had to be one of agency in which the consignee *only* has the power to sell.[44] When the agency relationship provided the consignee with authority beyond finding a buyer for the consignor's goods, courts said the relationship must have been more than a mere consignment—a "disguised security interest."[45]

Ultimately, the courts' treatment of alleged consignment arrangements has led to confusion. Concerned that parties might be attempting to obtain an unfair advantage against a consignee's creditors, courts continued to characterize consignment agreements as "conditional sales," or "disguised security interests."[46] These characterizations left consignors and consignees confused: what provisions can consignors provide in a consignment agreement other than the right to sell? Does the agreement have to set an exact price?

The courts were faced with competing concerns between consignors and consignees' creditors. On the one hand, the *Ludvigh* rule—that in a *true* consignment transaction the consignor is always protected against claims of the consignee's creditors—sometimes did nothing to

> protect innocent creditors of the consignee who may be misled

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42 Ludvigh v. Am. Woolen Co., 231 U.S. 522, 528–30 (1909).

43 *See generally* Reliance Shoe Co. v. Manly, 25 F.2d 381 (4th Cir. 1928) (consignment transaction in which the consignee had no right to return the merchandise unless the goods failed to conform with sample, the "consignor" was guaranteed the invoice price, and the agreement stated that "consignor" retained title, was not a mere consignment and the consignor thus did not have a supreme right of title to the goods against the "consignee's" creditors); *see also In re* Wayside Furniture Co., 67 F.2d 201 (7th Cir. 1933) ("Consignment" in which "consignee" had an option to either purchase the goods or sell the goods and deliver the proceeds to the "consignor" is deemed a conditional sale, not a consignment); *In re* Sachs, 30 F.2d 510 (4th Cir. 1929).

44 *See* William D. Hawkland, *Consignment Selling Under the Uniform Commercial Code*, 67 COM. L.J. 146, 148 (1962) (noting the relationship between consignor and consignee is one of agency).

45 *See* Marcone, *supra* note 4, at 594–95.

46 *See, e.g.*, *Ludvigh*, 231 U.S. 522, 528–30; *see also* GILMORE, *supra* note 1, §3.1–3.5, at 62–75 (discussing the distinction between a conditional sale and a true consignment, and that the consignments intended as security are more like conditional sales rather than true consignments).

> by the fact that [the consignee] is in possession of inventory against which no liens are filed and under circumstances in which he has the complete indicia of ownership.[47]

On the other hand, courts strove to afford creditors *some* degree of protection against hidden liens on the debtor's goods, but by doing so, the good faith consignor may have been treated unfairly by a court's characterization of the consignment transaction as something *different* than a mere consignment.[48] Moreover, the concept of a "secret lien," as an exception to the *Ludvigh* rule, further confused parties and courts: "it is not readily apparent why [the] consignment arrangement is not a secret lien against creditors of a shaky consignee, as harmful as an unfiled chattel mortgage or conditional sale."[49] Really, the *Ludvigh* rule, though partially undermined by courts' efforts to afford creditors some degree of protection against hidden liens, placed an intolerable burden on *bona fide*, good faith creditors who properly relied on property in the debtor's (consignee's) possession.

III. PRE-2001 UNIFORM COMMERCIAL CODE CONSIGNMENTS

A. *General Code Provisions*

To ameliorate, or perhaps rebel against, the common law of consignments (the *Ludvigh* rule), the drafters of the UCC sought to clarify the rights of consignors against a consignee's creditors by including *some* consignments within the ambit of UCC Article 9, treating *some* consignments as a security interest.[50] In 1962, the drafters of the UCC issued a comprehensive Code, in which a few select provisions provided consignors and consignees more guidance regarding the rights of consignors to their consigned goods.[51] The relevant provisions ultimately gave credence to prior

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47 *See* Hawkland, *supra* note 44, at 146; *see also Ludvigh*, 231 U.S. 522, 528–30.

48 *See* Hawkland, *supra* note 44, at 147 ("While these hostile decisions have given the consignee's creditors a measure of protection, they are unfair to a good faith consignor, for his decision to make a consignment sale may be dictated by considerations other than obtaining an unfair advantage over creditors.").

49 *See* Liebowitz v. Voiello, 107 F.2d 914, 916 (2d. Cir. 1939).

50 *See* Richard Duesenberg, *Consignments Under the UCC: A Comment on Emerging Principles*, 26 BUS. LAW. 565, 572-73 (1970) (discussing how the Uniform Commercial Code distinguishes Article 9 consignments as consignments intended as security with Article 2 consignments, which are not intended as security).

51 The statutory text of the 1962 Code, and the Code's subsequent amendments until 2001, differ significantly from the 2001 version. The language of the most recent pre-2001 Code section 2-326 provides, in relevant part:

> (1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is
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> (a) a "sale on approval" if the goods are delivered primarily for use, and
>
> (b) a "sale or return" if the goods are delivered primarily for resale.
>
> (2) Except as provided in subsection (3), goods held on approval are not subject

courts' preferences against hidden liens. This overturned the common law result; creditors were now protected at the expense of some consignors.[52]

Under the pre-2001 UCC ("Former UCC"), courts had to first look to section 1-201(37), which states, "*unless a consignment is intended as security*, reservation of title thereunder is not a 'security interest', but a consignment in any event subject to the provisions on consignment sales (section 2-326)."[53] One problem with the Former UCC is that it did not define consignment. Therefore, a court first had to determine whether a consignment was "intended as security."[54] Accordingly, Former UCC section 1-201(37), as an initial matter, deemed the "consignment" to be either a "security interest" governed by Article 9 when the consignment was intended as security, or a type of "sale" that fell under Former UCC section 2-326.[55]

If the consignment was intended as security, then Article 9 (Secured Transactions) governed.[56] When a transaction fell under Article 9, the transaction was deemed to create a "security interest" that required the consignor to "perfect" the security interest in order to obtain priority over the consignee's creditors. Primarily, consignors had to file a UCC financing statement to obtain priority over the consignee's unsecured creditors.[57]

If a consignment was not intended as security, then Article 2 (Sales), Former UCC section 2-326 governed. When a

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to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) 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).

U.C.C. § 2-326 (1990) (pre-2001 UCC) (emphasis added). The implications of this language will be discussed throughout this Note.

[52] *Cf.* William D. Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 469–72 (1963) (discussing how some UCC provisions overturned the common law result that transferors who retained title to the goods transferred would have better title than bona fide purchasers who purchased the goods from the transferee).

[53] U.C.C. § 1-201(37) (1990) (emphasis added).

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] *Id.* § 9-114 (1990).

consignment transaction fell under Former UCC section 2-326, art consignors were generally unable to prevail in retrieving their consigned goods—or the proceeds from the sale of those consigned goods—from the creditors' bankruptcy trustee.[58] An art consignment transaction could generally fall under two categories.[59] In assessing the category under which a transaction was characterized, courts and the UCC paid no mind to the parties' designation of a transaction as that of a "consignment."[60]

First, a court may have classified a "consignment" transaction as a "sale or return."[61] A "sale or return" was defined in Former UCC section 2-326(1) as a transaction in which the "delivered goods may be returned by the buyer even though they conform to the contract."[62] This seems to be most similar to the traditional consignment transaction in which a transferor, who retains title to the goods, delivers possession of the goods to a transferee for the purpose of sale; failure to sell results in return of the goods to the transferor-consignor—hence, "sale or return." Regardless of any notice on the part of the consignee's creditors that the goods may be returned to the transferor, the goods under the Former UCC, absent an enumerated exception, "[were] subject to [creditors'] claims while in the buyer's possession."[63]

Second, the Former UCC identifies a transaction that is neither a sale on approval nor a sale on return under UCC section 2-326(1) as a consignment where the "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 the delivery . . . ."[64] This transaction includes "true" consignments because goods are delivered for at least the limited purpose of sale. Prior to the UCC, these "true" consignors would have been protected against the claims of the consignee's creditors under the *Ludvigh* rule. Under Former UCC section 2-326(3), this type of transaction is *treated* as a sale or return, and, as stated before, a "consignor" in a sale or return transaction, absent an exception, will have no protection against the claims of the "consignee's" creditors.[65]

Although "sales or returns" (the first category) and UCC section 2-326(3) transactions that are *treated* as "sales or returns"

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58 *See* Marcone, *supra* note 4, at 582–83.
59 *See id.*; *see also* U.C.C. § 2-326 (1990) (pre-2001 UCC).
60 *See* U.C.C. § 2-326(3) (1990) (pre-2001 UCC) ("the provisions of [U.C.C. § 2-326(3) are applicable even though an agreement purports to reserve title to the person making the delivery until payment or resale or uses such words as 'on consignment' . . . ").
61 *See id.* § 2-326(1)(b).
62 *See id.*
63 *Id.* § 2-326(2).
64 *Id.*
65 *Id.*

(the second category) seem identical, the differences are important in understanding the ongoing revisions to the UCC. The former is an *actual* sale

> in which title to the goods and, unless otherwise agreed . . . the risk of loss to the goods (under UCC section 2-327(2)(b)), is initially transferred to a buyer for the ultimate resale to a third party. (Under UCC section 2-106(1), a "sale" consists of "the passing of title from a seller to a buyer for a price.")[66]

The latter is not a sale. It is a bailment for the purpose of entrusting—not selling—the goods to the bailee (consignee) until the items are purchased by a third party.[67] In this transaction, the consignee retains title and risk of loss to the goods.[68] The Former UCC treats both transactions the same; consignors' rights in the goods are subordinated to the claims of the consignee's secured creditors. Later, the UCC's 2001 revisions distinguish these two transactions.[69]

B. *The Exceptions—A Consignor's Path to Protection*

To summarize thus far, sale or return transactions (the first category) and section 2-326(3) transactions in which the owner delivers goods for purposes of sale (second category), subordinate the "consignor's" rights to those of the "consignee's" creditors unless the *consignor* can prove any of the exceptions in Former UCC section 2-326(3)(a)–(c).[70] To obtain protection against claims by a "consignee's" third-party secured creditors, a "consignor" must prove any of the following exceptions to the general rule that creditor claims are superior to the rights of the consignor: the consignor

> (a) evidences his interest with a sign on his consigned good, but only if in compliance with a statute,
>
> (b) establishes that the [consignee] is generally known by his creditors to be substantially engaged in selling the goods of others, or
>
> (c) files a financing statement as if the transaction were under

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66 Raymond W. Dusch, *Court Negates UCC Article 9 Consignment Law Improvements*, THE SECURED LENDER (July 1, 2004), http://findarticles.com/p/articles/mi_qa5352/is_200407/ai_n21353123/?tag=content;col1.

67 *Id.*

68 *Id.*

69 *See* U.C.C. §§ 2-326(2)–(3) (1990) (pre-2001 UCC) (making no distinction between consignments treated as "sales or returns" under section 2-326(3) and actual "sales or returns" under section 2-326(2)).

70 *See* U.C.C. § 2-326(2), (3) (1990) (pre-2001 UCC).

Article 9 on Secured Transactions.[71]

The first "sign-posting" exception is insignificant because the UCC does not have a sign law and only two states have enacted sign laws related to consignment transactions.[72] On rare occasions, courts have misread the sign-posting exception and have suggested that consignors could protect themselves by posting a sign on the consigned good even in the absence of a sign-posting statute.[73] The majority of courts, however, interpret the UCC correctly and hold that the absence of a statutory sign-posting law prohibits protecting the consignor under the exception in Former UCC section 2-326(a).[74]

The "generally known" exception in subsection (b) is most troublesome. The exception puts the burden of proof on the consignor to prove that the consignee's creditors generally know that the consignee is *substantially* engaged in selling the goods of others.[75] This exception raises important legal questions: what does it mean for a creditor to generally know that the debtor is *substantially* engaged in selling the goods of others? Is actual knowledge by a specific creditor at issue sufficient, or must the consignor prove general knowledge among an aggregate of creditors? What does the UCC mean by "substantially?"

Art consignors, apart from many other types of consignors, are at a significant disadvantage in proving this exception. First, art consignors could have trouble proving the "substantially engaged in selling the goods of others" part of the exception. Art dealers do not solely *sell* art; they also display art that is on loan from artists, collectors, and other dealers.[76] The dealers also sell art that is not on consignment—for example, an artist who sells the work to the dealer as a sale on approval or as a traditional sale. This variety of works for sale or on display has left open the possibility that creditors can rebut a consignor's argument by claiming that the consignee does not substantially *sell* the goods of others because many works are on loan, owned by the dealer, or simply on display.[77]

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71 *See id.* § 2-326(3)(a)–(c).
72 *See, e.g.*, MISS. CODE ANN. § 15-3-7 (West 1989).
73 Marcone, *supra* note 4, at 600 n.122; *see also* Medalist Forming Sys., Inc. v. Malvern Nat'l Bank, 832 S.W.2d 228 (Ark. 1992).
74 Marcone, *supra* note 4, at 600.
75 *See* U.C.C. § 2-326(3)(b) (1990) (pre-2001 UCC).
76 *See* Hillary Jay, Note, *A Picture Imperfect: The Rights of Art Consignor-Collectors When Their Art Dealer Files for Bankruptcy*, 58 DUKE L.J. 1859, 1870 (2009).
77 *See id.* Although the works on display, and not for sale, at an art dealership are the goods of others, those goods are not to be sold. Because the goods are not to be sold, the consignor cannot use works that are merely on display to argue that the consignee is "substantially engaged in selling the goods of others . . . ." *See* U.C.C. § 2-326(3)(b) (1990) (pre-2001 UCC). This difference may be irrational. If an artist or collector loans

Second, art consignors have trouble proving the "generally known" part of the exception. The consignor must first prove that the majority[78] of the consignee's creditors were actually aware that the consignee was substantially engaged in consignment sales.[79] To illustrate the problem of proof for the art consignor, consider the "consignee-dealer" who has five creditors. Four of the creditors extend credit to the dealer for minor improvements to the dealer's facilities. The remaining creditor makes ten loans at various times for the debtor's operating activities. The creditor who makes ten loans may very well represent two-thirds of the claims, and, indeed, may have provided the debtor with ninety percent of her financing. In such a case, the courts would require the consignor to prove that at least three of the five creditors knew that the consignee was substantially engaged in selling consigned goods in order to satisfy the "generally known" test.[80] The less significant four creditors, who perhaps only account for ten percent of the consignee's leverage, may, as a matter of expedience, not conduct as much due diligence to understand the operations of the consignee.[81] Therefore, it would be difficult to prove that those four creditors generally knew that the debtor was substantially engaged in selling consigned goods. The largest creditor, who makes up the majority of claims and the majority of secured credit, is the most significant creditor. Even while the most significant creditor might actually know that the debtor substantially deals in consigned works, the consignor would be unlikely to prevail against the creditors' claims because the majority of creditors did not know that the debtor was substantially engaged in selling consigned works.[82]

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an artwork to a gallery or dealer without the purpose of sale, then the artist is likely protected under the common law. The artist who puts a work on display for purposes of sale, however, is at a substantial disadvantage to establish a successful claim for the goods against the consignee's secured creditors. This difference in treatment is arbitrary. In both situations, the consignee's creditors and patrons see the art plainly on display. The only difference is that one artwork may have a price-tag while the other does not. Both situations imply that the consignee may own both works—at least from the creditors' perspective—because the loaned work may be viewed as a fixture and the consigned work may be viewed as inventory. In either case, protecting the artist-lessor under the *Ludvigh* rule while affording the artist-consignor who seeks to sell his work substantially less protection under the U.C.C. is arbitrary. *See, e.g.,* Ludvigh v. Am. Woolen Co., 231 U.S. 522, 528–30 (1909).

78 "Majority" means the majority of creditors, not the majority of creditors' claims. *See In re* Valley Media, Inc., 279 B.R. 105, 125 (Bankr. D. Delaware 2002).

79 *See id.*

80 *See* U.C.C. § 2-326(3)(b) (1990) (pre-2001 UCC).

81 This is particularly true if the loan is insignificant in amount compared to the value of the debtor's perceived assets.

82 But "some courts have held that an individual creditor of the consignee with *actual* knowledge of the consignment relationship does not need protection from potential secret liens." *Valley Media, Inc.*, 279 B.R. at 125 n.36 (emphasis added) (creditor with knowledge of consignment had no right under UCC section 2-326 to proceeds of inventory sale)); *see also* Eurpac Svc. Inc. v. Republic Acceptance Corp., 37 P.3d 447, 450-

The third exception protected the owner of the consigned goods—so long as the parties did not intend the transaction to create a security interest[83]—if the owner conformed to Former UCC section 9-114's filing requirements. This exception provided consignors an opportunity to secure their interest in the consigned goods, permitting the consignor to be considered a secured creditor. To secure one's interest, an owner must have met several statutory requirements: (1) the consignor must have filed an Article 9 financing statement *before* delivering possession of the goods to the consignee;[84] (2) the consignor must have previously provided written notification to the consignee's creditors who have filed a financing statement to secure goods of the "same type" as the consigned goods;[85] (3) the third party creditor must actually have *received* the written notification within the five years before the consignee took possession of the goods;[86] and (4) the notification itself must have included specific information—that the consignor expects to deliver consigned goods to the consignee-debtor as well as a specific description of the item or item type.[87] If any of these four stringent requirements were not met, then the consignor's interest in her own consigned goods to which the consignor retained title would be subordinated to the interests of the consignee's secured creditors.[88]

The problems with the third exception are readily apparent for art consignors. Generally, because of the uniqueness, discussed above, of the art market, artists are quite likely to be unaware of or unwilling to comply with the UCC's filing requirements.[89] To illustrate, take Landscape Artist, a career landscape painter. Landscape Artist painted a treescape and entered into a consignment agreement that provides that the art dealer will attempt to sell Landscape Artist's painting for an unspecified price. The agreement, being informal, was made on the spot, and the artist, immediately upon execution of the

51 (Colo. Ct. App. 2000). Even though some jurisdictions preclude creditors with *actual* knowledge of consignments from collecting proceeds from an inventory sale, there may remain other creditors who lacked actual knowledge. Those creditors without actual knowledge presumably would still have a right to collect the proceeds from an inventory sale of consigned goods.

83 *See* U.C.C. § 1-201(37) (1990) (pre-2001 UCC) ("unless a consignment is intended as security, reservation of title thereunder is not a 'security interest', but a consignment in any event subject to the provisions on consignment sales (Section 2-326).").

84 *See id.* § 9-114(1)(a) (repealed July 1, 2001) (similar provisions found in U.C.C. §§ 9-103, 324 (enacted July 1, 2001)).

85 *See id.* § 9-114(1)(b).

86 *See id.* § 9-114(1)(c).

87 *See id.* § 9-114(1)(d).

88 *See id.* § 9-114(2).

89 *See supra* notes 18–25 and accompanying text (discussing the "uniqueness" of the art market and noting that formalistic legal requirements insult the trust between art consignor and consignee-dealer, often resulting in no transaction).

agreement, delivered the artwork to the shop. Immediately upon delivering possession of, but not title to, the painting, the artist expects that in time she will receive either the consigned painting or money from the sale of the painting. During the period of the consignment agreement, the art dealer defaulted on its credit obligations and subsequently filed for bankruptcy.

Here, even if the artist filed a financing statement, the artist would lose the artwork to any secured creditors' claims because the artist failed to file the financing statement *before* delivering possession of the goods.[90] Failure to file a financing statement before delivering possession is common in the art market.[91] Indeed, filing a financing statement is rare for artists anyway.[92] Therefore, artists will typically lose the value of their art, in addition to the artwork itself, to secured creditors. The effect of subordinating the artist's claim for failure to file a financing statement or to file a financing statement *before* delivery of possession of the consigned goods results in the consignor being an unsecured creditor. When courts treat art-consignors as unsecured creditors, then the secured creditor will realize the value of the consigned artwork, which is similar to a theft of the consigned goods by the debtor to fulfill the debtor's obligations to its secured creditors in bankruptcy.[93] The failure to meet the requirements under the filing exception, assuming that no other UCC exception is met, summarily means that the consignor has no recourse against the consignee's secured creditors.[94]

Even more troublesome for art-consignors, who are generally unaware of the UCC's requirements under the financing statement exception, is the requirement that the art-consignor provide detailed notice to the consignee's secured creditors that

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90 *See* U.C.C. § 9-114(1)(b) (repealed July 1, 2001) (similar provisions found in U.C.C. §§ 9-103, 324 (enacted July 1, 2001)).

91 *See supra* notes 18–25 and accompanying text (discussing the "uniqueness" of the art market and noting that formalistic legal requirements insult the trust between art consignor and consignee-dealer, often resulting in no transaction).

92 *Id.*

93 *See* Richard L. Stehl, *Eligibility for Damage Awards Under 11 U.S.C. § 362(h): The Second Circuit Answers the Riddle—When Does Congress Actually Mean What It Says?*, 65 ST. JOHNS. L. REV. 1119, 1123 n.18 (1991) (discussing the order of distributions in bankruptcy as first to secured creditors, then to priority claims, then to unsecured claims, etc.).

94 The consignor has a claim against the consignee-debtor, however, based on principles of agency. But the claim against the consignee is often futile because the consignee has an incorporated business or the consignee, if operating the business as a sole proprietor, will have little to no assets left for unsecured claims after filing for bankruptcy. For consignees who are incorporated, they generally agree in a corporate rather than a personal capacity. Even if the agreement is not memorialized in a writing, as is typical of art-consignment agreements, the consignor will be unlikely to prevail in a suit against the consignee for failure to perform—that is, failure to either return the consigned work or deliver to the consignor proceeds for the value or the sale of the consigned work. To go after the consignee personally, the consignor will have to pierce the consignee's corporate veil, which generally requires the unlikely showing of fraud or comingling of funds.

the artist has consigned goods to the consignee-debtor.[95] This requires the potentially legally unsophisticated art-consignor to conduct a search of public records to determine whether the consignee has any secured creditors. Then the consignor must determine whether the secured creditors, if any, have a secured interest in any goods of the same type or kind as the consignor's good. Finally, the consignor must deliver a detailed description of the consigned good to the secured creditor (and there may be many more than one secured creditor).[96] This technical process is commonly unheard of by the art-consignor and often insults the trust between art consignor and art consignee.[97]

IV. EFFICACY OF STATUTORY RESPONSES TO THE PRE-2001 UCC

A. *The Statutes*

To address the unique problems of inequity for artists in art consignments, at least twenty-eight states adopted art consignment statutes before 2001 that purported to provide special protection to *artists*—and generally only artists, not collectors—who consign goods to art dealers.[98] After 2001—as of 2005—there are only thirty-one states with art consignment-protection statutes.[99] These statutes are generally less effective than they purport to be.[100]

The most effective statutes provide automatic protection to artists against creditors' claims. The New York and California statutes, for example, treat the consigned artwork as "trust property" held for the benefit of the consignor, and provide that the consigned work automatically obtains priority over any claims or liens against any property of the consignee.[101] These statutes also do not have a written-agreement requirement, and they protect the artist regardless of the consignor's nonconformance with any UCC provisions.[102]

Other less effective statutes left the artist-consignor

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95 *See* U.C.C. § 9-114 (repealed July 1, 2001) (similar provisions found in U.C.C. §§ 9-103, 324 (enacted July 1, 2001)).
96 *See id.*
97 *See supra* notes 18–25 and accompanying text (discussing that formalistic legal requirements insult the trust between art consignor and consignee-dealer, often resulting in no transaction).
98 *See* Marcone, *supra* note 4, at 589.
99 1 RALPH E. LERNER & JUDITH BRESLER, ART LAW: THE GUIDE FOR COLLECTORS, INVESTORS, DEALERS, AND ARTISTS 39 (3d ed. 2005).
100 *See infra* notes 105–14 (discussing statutes that are less effective in protecting consignors' interests in consigned goods when the consignee's property becomes subject to the claims of the consignee's creditors).
101 *See* N.Y. ARTS & CULT. AFF. LAW §§ 12.01, 12.03 (McKinney Supp. 1991); *see also* CAL. CIV. CODE § 1738.5–9 (West 1985).
102 *See* U.C.C. § 9-114 (repealed July 1, 2001) (similar provisions found in U.C.C. §§ 9-103, 324 (enacted July 1, 2001)); *see also supra* Part III.B (discussing the formal writing requirements to perfect a security interest under Article 9).

potentially worse off than if only the UCC applied, even though the statutes purported to provide the art-consignor more protection.[103] Some state legislatures, with the idea of protecting artists, sometimes only defined the rights as between consignor and consignee, failing to adequately address the core issue: the inadequate protections afforded artists under the UCC against the consignee's creditors.[104] Yet, in other states, such as Florida, the statute requires the artist or the consignee to conform to statutory requirements similar to those in the UCC; for example, Florida requires that the artist and the consignee provide notice to creditors by posting a sign on the consigned work.[105] This requirement merely retraces the sign-posting exception in the UCC, failing to address the problem that art-consignors are often legally unsophisticated parties, thus leaving the artist to hope that the consignee conforms to the mandated sign-posting.[106] Other ineffective statutes impose criminal sanctions upon the consignee for failing to execute a written consignment agreement with the consignor.[107] Imposing a criminal penalty on the *consignee* for failure to execute a written agreement may be effective as to establishing the rights between consignor and consignee, but the criminal penalty does not address the rights between consignor and the consignee's creditors—if anything, one could imagine such criminal penalties as discouraging consignees from accepting consignments.[108]

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103 *See* Marcone, *supra* note 4, at 590 ("[The Statutes'] formalities seem contrary to the central purpose of these statues, which is to secure the rights of the artist to his work without requiring the artist to comply with legal procedures as formal as those specified in the UCC.").

104 Oregon, for example, requires the artist-consignor and the consignee to execute a written consignment agreement. *See* OR. REV. STAT. § 359.220 (Butterworth 1987). The statute places the burden of executing the written agreement on the consignee, and failure to do so makes the consignee liable to the consignor. *Id.* § 359.220(1). This statute still fails to address the rights between consignor and the consignee's creditors, and the consignor may be left without recourse against the consignee because the consignee may very well have insufficient assets to deliver the value of the consigned work to the consignor.

105 *See* FLA. ANN. STAT. § 686.502(2) (West 1990).

106 *See* U.C.C. § 2-326(3)(a) (1990) (pre-2001 UCC). *But see* FLA. ANN. STAT. § 686.502(2) (West 1990) (requiring consignors and consignees to "affix a sign or tag" or affix a general notice in the consignee's place of business that puts the world on notice that some goods are being sold on consignment).

107 Oregon's statute is one example:

> It shall be unlawful for a consignee willfully and knowingly to secrete, withhold or appropriate a work of fine art or the proceeds from sale thereof for the consignee's own use or the use of any person other than the consignor, except pursuant to a bona fide sale or as otherwise consistent with the terms of consignment. Violation of this section is a Class C felony.

OR. REV. STAT. § 359.240 (West 2003).

108 The consignment issues presented in this Note are not about consignors' rights against the rights of the consignees because the entire issue is whether or not the consignor or consignee's creditors have a superpriority claim to *limited* assets available to make the parties whole after the consignee files for bankruptcy.

B. *The Repealer Problem*[109]*—The UCC Could Previously Trump Consignment Protection Statutes*

Yet another wrinkle, regardless of how well a given state statute intended to protect artists in consignment agreements, was the Repealer Provision of the UCC. Section 1-104 of the UCC provides that "no part of [the UCC] shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided."[110] Indeed, the UCC official comments provide that the UCC is "carefully integrated and intended as a uniform codification of *permanent* character covering an entire 'field' of law, and is to be regarded as *particularly* resistant to implied repeal . . . ."[111] This presents a unique problem that state legislatures may not have adequately addressed: how specific must a subsequent statute, which purports to protect artists in consignment agreements, be in order to supersede the UCC?

Because the UCC is particularly resistant to repeal by subsequent legislation,[112] creditors may argue that even if an artist-consignment protection statute affords the artist *per se* protection against creditors' claims when the artist fails to conform to the UCC requirements,[113] the statute fails to adequately repeal the relevant provisions of the UCC, thus deeming the artist-protection statute ineffective in protecting the artist against the creditors' claims. Some statutes provide no language regarding repeal of any other statute, making art-consignments in those states particularly susceptible to the creditors' argument that the UCC trumps the state statute.[114] Other statutes use boilerplate, "notwithstanding any other law" language or "all acts and laws to the contrary notwithstanding" language, to attempt to repeal, or supersede rather, the relevant UCC provisions.[115]

The most successful statutes, however, *specifically* repeal provisions of the UCC that may conflict with the artist-consignment protection statute.[116] Some authorities suggest that the statute must repeal specific provisions of the UCC.[117]

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109 Section 1-104 of the UCC is known as the "Repealer" Provision.
110 *See* U.C.C. § 1-104 (1990).
111 U.C.C. § 1-104 cmt. (1990) (emphasis added).
112 *See id.* and accompanying discussion.
113 *See* U.C.C. §§ 2-326, 9-114 (1990) (pre-2001 UCC) (provisions similar to those in pre-2001 UCC § 9-114 are now codified in U.C.C. §§ 9-103, 324 (enacted July 1, 2001)).
114 *See, e.g.*, MISS. CODE ANN. § 15-3-7 (West Supp. 1989)
115 *See* OR. REV. STAT. § 359.205 (1985) ("notwithstanding any custom, practice, or usage of the trade to the contrary . . .").
116 *See* N.Y. ARTS & CULT. AFF. LAW § 12.01(1) (McKinney 1994) ("Notwithstanding any custom, practice or usage of the trade, any provision of the uniform commercial code or any other law, statute, requirement or rule, or any agreement, note, memorandum or writing to the contrary . . . ").
117 *See* TAD CRAWFORD & SUSAN MELLON, THE ARTIST-GALLERY PARTNERSHIP: A PRACTICAL GUIDE TO CONSIGNING ART 65 (1998).

Generally, courts have attempted to construe the UCC and the artist-protection statute harmoniously.[118] Therefore, the most successful statutes that *per se* protect the art-consignor's interest against claims of the consignee's creditors may actually provide the artist no protection at all if the act does not repeal or supersede the UCC expressly. This presents another unique issue. It is more likely as a matter of practice that an artist is aware of *art-specific* laws rather than general laws that cover a large field of law, for example the UCC. If the artist were aware of a statute that, in the best case, protects the art-consignor's interest *per se*, then the artist would presumably rely on the statute. Therefore, even if the art-consignor is a legally sophisticated party who knows about the UCC requirements, the consignor may take the easier path and not conform to the UCC requirements because the art law already protects the artist regardless of UCC requirements. However, should a court deem that the statute inadequately repeals the UCC or that the statute should be read "harmoniously," thus requiring the artist to *also* conform to the UCC's requirements, then the artist may actually have a subordinated interest in the goods to which she holds title to the interest of the consignee's creditors.

Fortunately, UCC revisions in 2003 at least afforded these artist protection statutes *per se* applicability to post-2001 UCC non-Article 9 art consignments, so long as the consignments are not intended as security or otherwise fall under Article 9.[119]

V. THE 2001 UCC REVISION

A. *The Purpose of Revision: The Pre-2001 UCC Was Inequitable For Some Consignors*

The problem with Former UCC Article 2 was that it went too far in overturning the *Ludvigh* common law rule that "true" consignments should not be subject to the claims of a consignee's secured creditors.[120] The Former UCC was draconian for art

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118 *See, e.g.*, Jackson v. H. Frank Olds, 382 N.E.2d 550, 555 (Ill. App. Ct. 1978) ("[W]hen two statutes relate to the same subject matter, provided that the newer act does not expressly state that it is the exclusive remedy, the two should be construed harmoniously." (citing People ex rel. Scott v. Illinois Racing Bd., 301 N.E.2d 285 (Ill. 1973))).

119 U.C.C. § 2-108(1)(c)(iii), (2), (3) (2011).

120 See, for example, Marcone, *supra* note 4, at 608, which summarizes why the Former UCC went too far in subordinating art consignors' claims to those of the consignees' secured creditors:

> While such an approach benefits from a certainty which is bound to lower transaction costs, the case law suggests another approach under circumstances in which rigid adherence to ostensible ownership principles, and hence rigid construction of Section 2-326, produces results that are inequitable. We have seen, for example, that when the normative assumptions about the players do not hold, as when the owner of goods is characterized as a "little fellow" and the

consignors. If any consignor failed to prove a difficult-to-prove exception, the consignor's interest in her consigned goods was automatically subordinated to the claims of a consignee's secured creditor in bankruptcy. For example, one commentator praised that Former UCC section 2-326 discouraged commercial parties from using a "consignment" device "to achieve a status more favorable than that accorded other parties which have unperfected security interests."[121] The same commentator also suggested that the stringent provisions of Article 2 should not apply to consumer consignors—for example, the common artist.[122] Moreover, some courts even artfully construed the Former UCC to protect consignors who appeared to be more innocent than the creditors who would otherwise be automatically protected by Former UCC section 2-326.[123]

B. *The Revision Process "Orphaned" Consignors it Sought to Protect*

To more equitably balance the competing interests of the consignor and the consignee's secured creditors,[124] the Article 2 and Article 9 study committees went through an extensive revision process that sought to place many consignors, including many art consignors, in a better position than that which was afforded by the Former UCC. Unfortunately, the long process left many art consignors worse off than before the 2001 revisions.

Initially, in its 1996 draft, the drafting committee removed consignments from Article 2 (Sales) to Article 9 (Secured Transactions).[125] But the committee also left the "sale or return" transaction within Article 2. This is significant because the Former UCC treated consignments like a "sale or return."[126] This left the

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> creditor in question happens to be a large national financing company, some courts attempt to work around the rather strict commands of the Code. Also, where the consignor might appear more "innocent" than the secured creditor, many courts are reluctant to find for the creditor, even if the language of exception (b) requires not knowledge by one creditor but knowledge by creditors as a group.

Id.

121 John Dolan, *The UCC's Consignment Rule Needs an Exception for Consumers*, 44 OHIO ST. L.J. 21, 42 (1983).

122 *Id.* at 21–22.

123 *See, e.g.*, *Union State Bank of Hazen v. Cook*, 63 B.R. 789 (Bankr. N.D. 1986) (holding for consignor notwithstanding Article 2 when creditor acted casually about the origin of the consigned goods); First Nat'l Bank of Blooming Prairie v. Olsen, 403 N.W. 2d 661 (Minn. Ct. App. 1987) (notwithstanding section 2-326, consignor prevailed when creditor had knowledge of customs).

124 *See* Marcone, *supra* note 4, at 608–09 (discussing commentators' opinions to balance the equities between consignor and secured creditors of the consignee).

125 *See* Richard E. Speidel, Progress Report to NCCUSL (Jul. 1996) (draft) (on file with U. of Pennsylvania Biddle Law Library), *available at* http://www.law.upenn.edu/bll/archives/ulc/ucc2/ucc20596.htm ("[T]he Drafting Committee, at the March, 1996 meeting, voted to move the rights of a consignor against creditors of a consignee from [Article 2] . . . to Article 9.").

126 *Id.* ("Section 2-406 has been revised to include all material on the nature and the

committee with questions: "[s]hould [the sale or return] be treated as a consignment? If so, what parts should be governed by Article 9? If not, what should the Article 2 rule for creditors be?"[127]

The committee soon answered these questions, excluding non-Article 9 consignments from Article 2 and leaving such consignments to the original art consignor-friendly common law of bailments. In a 1997 letter, Richard E. Speidel stated that "Article 2 does not treat consignments, whether for security or not."[128] In response, the drafting committee in 1997 stated that "there are no code provisions covering a 'pure' consignment, i.e., a bailment with the bailee acting as an agent with power to find a buyer for the consigned goods and to transfer good title by a contract for sale to that buyer."[129] This suggests that "true" consignments should neither be governed by Article 2 nor Article 9; they should be governed by the common law of bailments, which favored consignors. The study committee also sought to leave to the common law non-Article 9 consignments that are not "true" consignments nor consignments that are within Article 9's narrow definition of consignments.[130] Herein lies the problem, and one must understand the final 2001 UCC provisions to understand why art consignors are now in a worse position than before the revisions. As you will see, courts ignore the drafters' intended treatment of non-Article 9 consignments and subject such consignments to the draconian "sale or return" rules of

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special incidents of 'sale or return' and 'sale on approval' in one section.").

127 *Id.*

128 Memorandum from Richard E. Speidel, Reporter, to the Article 2 Drafting Committee (Jan. 1, 1997) (on file with U. of Pennsylvania Biddle Law Library), *available at* http://www.law.upenn.edu/bll/archives/ulc/ucc2/statj97.htm ("Section 2-407 in the July, 1996 Draft has been deleted. Article 2 does not treat consignments, whether for security or not. Assignment issues are resolved under either non-code law or Article 9.").

129 Notes to Section 2-506, Draft of Uniform Commercial Code Revised Article 2 Sales, The Nat'l Conference of Comm'rs on Uniform State Laws (Mar. 21, 1997) (on file with U. of Pennsylvania Biddle Law Library), *available at* http://www.law.upenn.edu/bll/archives/ulc/ucc2/397art2.htm.

130 *See* Reporter's Notes, Revision of Uniform Commercial Code Article 2, The Nat'l Conference of Comm'rs on Uniform State Laws (Mar.,ch 2000) (on file with U. of Pennsylvania Biddle Law Library), *available at* http://www.law.upenn.edu/bll/archives/ulc/ucc2/2300.htm. These notes stated the following with respect to U.C.C. § 2-326:

> The Article 9 definition of "consignment" does not cover transactions in which the consignor is a consumer, the consignee is an auctioneer or is generally known by its creditors to be substantially engaged in selling the goods of others, or the aggregate value of each delivery is $1,000 or more. Because original Section 2-326(3) has been eliminated, most such transactions will not qualify for sale-or-return status; that is, title to the goods will not pass and thus the consignee will not be a "buyer" as that term is used in subsection (a). If the transactions are entrustments the consignor's interest will be severed by a buyer in ordinary course (Section 2-403), but otherwise they will be governed by the common law of bailments and the question whether the goods are subject to the claims of the consignee's creditors must be resolved by reference to [the common law].

Id.

Former UCC section 2-326.[131]

C. The New Provisions

In 2001, for the first time, the drafters of the UCC defined consignments for UCC purposes.[132] Namely, the drafters removed all "consignment" language from Article 2 (as formerly reflected in UCC section 2-326), and brought many, but not all, consignments within Article 9.[133] Under the UCC, a consignment is defined more narrowly than what has traditionally been viewed as a "true" consignment. Traditionally, consignments have been viewed, at least outside of the UCC, as transactions in which an owner of goods delivers possession of the goods to another for the purpose of sale;[134] formerly, this traditional consignment was governed by Former UCC section 2-326(3), which has now been deleted. The UCC's narrower definition, however, has several requirements for a consignment to be governed by revised Article 9.

The non-problematic requirements to be a UCC consignment are summarized as follows. First, the goods must be delivered, or "consigned," to a "merchant"[135] for the purpose of sale.[136] Second,

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131 *See infra* notes 162–67 and accompanying text (discussing courts' treatment of consignments under the UCC after the 2001 revisions).

132 The UCC defines consignments in section 9-102(a)(20), reproduced below:

> (20) "Consignment" means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:
>
> (A) the merchant:
>
> (i) deals in goods of that kind under a name other than the name of the person making delivery;
>
> (ii) is not an auctioneer; and
>
> (iii) is not generally known by its creditors to be substantially engaged in selling the goods of others;
>
> (B) with respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery;
>
> (C) the goods are not consumer goods immediately before delivery; and
>
> (D) the transaction does not create a security interest that secures an obligation.

U.C.C. § 9-102(a)(20) (effective July 1, 2001).

133 Current U.C.C. section 2-326 now reads as follows:

> (1) Unless otherwise agreed, if delivered goods may be returned by the buyer even if they conform to the contract, the transaction is:
>
> (a) a "sale on approval" if the goods are delivered primarily for use; and
>
> (b) a "sale or return" if the goods are delivered primarily for resale.
>
> (2) Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.
>
> (3) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section 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).

U.C.C. § 2-326 (2009) (post-2001 UCC).

134 *See, e.g.*, GILMORE, *supra* note 1, § 3.5, at 73.

135 Generally, whether a consignee is a merchant is a nonissue regarding the rights of art-consignor vis-à-vis the consignee's creditors.

136 *See* U.C.C. § 9-102(20) (2011) (post-2001 UCC). The UCC defines "merchant" in

the art-dealer, or "merchant" rather, must deal in goods of the consigned good's kind under a name that is different from the consignor's name.[137] Third, the merchant cannot be an auctioneer.[138] Fourth, the aggregate value of the owner's consigned goods to the dealer must be $1,000 or more at the time of delivery.[139] This automatically excludes "immaterial" consignments—meaning consignments of goods whose aggregate value is less than $1,000—from the purview of Article 9. Fifth, the transaction must "not create a security interest that secures an obligation."[140] To "secure[] an obligation" means that if the consignee fails to sell the unsold goods, then the consignee must pay for the unsold goods rather than return the goods.[141]

There are two problematic requirements in the UCC *definition* of consignments. First, the merchant art-dealer must *not* be "generally known by its creditors to be substantially engaged in selling the goods of others."[142] Under the Former UCC, if the art-consignor could establish that the consignee was "generally known by [its] creditors to be substantially engaged in selling the goods

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section 2-104(1) as a person

> that deals in goods of the kind or otherwise holds itself out by occupation as having knowledge or skill peculiar to the practices or goods involved in the transaction or to which the knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that holds itself out by occupation as having the knowledge or skill.

U.C.C. § 2-104(1) (2011). The "for purpose of sale" requirement means for the purpose of the *consignee* to sell. *See In re* Georgetown Steel Co., 318 B.R. 352, 358 (Bankr. D.S.C. 2004).

137 *See* U.C.C. § 9-102(20)(A)(i) (2011) (post-2001 UCC). The meaning of "deals in goods of that kind" generally means goods of the specific kind of inventory. *See In re Georgetown Steel*, 318 B.R. at 358–59. One might think that "goods of that kind" means "works of art" in the art-dealer context. However, at least one court has suggested that there may be a difference between works of art and *quality* of art. *See* Spainerman Gallery v. Merrit, No. 00Civ.5712LTSTHK, 2003 WL 289704, at *6 (S.D.N.Y. Feb. 6, 2003) (suggesting that a reasonable jury could find that a dealer that sells "'art' that might also be 'junk'" is of a different kind of dealer for U.C.C. purposes than one that sells "fine" art).

138 *See* U.C.C. § 9-102(20)(A)(ii) (2011).

139 *See* U.C.C. § 9-102(20)(B) (2011). This aggregate value requirement could create a valuation problem unique to works of art. *See* John G. Steinkamp, *Fair Market Value, Blockage, and the Valuation of Art*, 71 DENV. U. L. REV. 335, 338 (1994) ("[V]aluation of art is an inherently subjective process and experts' opinions often vary dramatically."). Consider that a work of art is *maybe* valued near $1,000. If the value is debatable, then an art-consignor may not attempt to litigate against the creditors because valuation may require expert witness testimony, which is often expensive and may very well exceed the range of values attributable to the work of art. In such a case, the consignor may simply abandon his claim to the art to which she holds title.

140 See U.C.C. § 9-102(20)(D) (2011).

141 *See Georgetown Steel*, 318 B.R. at 360 ("Whether an interest "secures an obligation" has been described as dependent upon whether there is a duty to pay for unsold goods." (citing WHITE & SUMMERS, UNIFORM COMMERCIAL CODE, § 30-4 (5th ed. 2002))). This is a nonissue in art consignments because the artist does not deliver possession of the goods with the guarantee that the consignee will pay the purchase price of the goods. This type of "secur[ing] an obligation" is essentially a deferred sale in which the consignor delivers possession of the goods, expecting to receive the price of the goods at some later time notwithstanding sale of the goods.

142 *See* U.C.C. § 9-102(20(A)(iii) (2011).

of others," then the art-consignor could obtain superpriority over secured creditors' claims.[143] Proving that a dealer does not meet this "not generally known" criterion is equally as difficult for the art consignor as proving the same exception in the Former UCC.[144]

Second, the drafters of the UCC imposed a new requirement that consignments do not include goods that are "consumer goods" immediately before the consignor delivers possession of the good.[145] Consumer goods are "goods that are used or bought for use primarily for personal, family, or household purposes."[146] Art-consignors' problem with the distinction between consumer goods and non-consumer goods is not readily apparent. For example, a career-painter—who presumably paints, then sells, to make a living—delivers possession of her recent masterpiece to an art-dealer for purposes of sale. This painting would not be considered a consumer good because it was neither "bought" nor "used" *primarily*, indeed at all, for personal, family, or household purposes.[147] This painter is simply trying to earn money by selling a work that she created in order to support her lifestyle. Now, imagine a second painter—the hobbyist, who paints for what are usually considered non-commercial reasons. This hobbyist painter created a masterpiece, similar to the one of the career-painter, except the hobbyist painter decided to hang her masterpiece on her wall for decorative purposes. This use is "personal" under UCC section 9-102(a)(23) because it was "used . . . primarily for personal, family, or household purposes."[148] A week later, this painter may run into financial difficulty, seeking to sell the newly created masterpiece to make some money. Presumably, because the painting was produced *originally* for primarily "personal" purposes, this is a consumer good that falls outside the ambit of Article 9.[149] The first painter, the career-painter, falls within Article 9 and must meet its strict statutory requirements in order to obtain protection against third party creditors' claims.[150] The

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143 *See* U.C.C. § 2-326(3)(b) (1990) (for the pre-2001 version of U.C.C. § 2-326). The old UCC explicitly treated this as an exception and revised Article 9 treats it as an implicit exception. *See* U.C.C. § 9-102(a)(20)(A)(iii)) (2011) (post-2001 UCC). The distinction is insignificant.

144 *See supra* Part III.B (discussing the troublesome "generally known" exception).

145 *See* U.C.C. § 9-102(a)(23) (2011) (post-2001 UCC).

146 *See id.*

147 *See id.*

148 *See id.*

149 *See id.*; *see also* Mackela v. Bentley, 614 S.E.2d 648 (S.C. Ct. App. 2005) (seller who originally purchased a vehicle for personal use and later tried to sell the vehicle at a car dealership retained its "personal" character and the vehicle, therefore, is a consumer good).

150 *See generally* U.C.C. § 9-102(a)(20), (23) (2011). This career-painter's works are *not* consumer goods. *See* U.C.C. § 9-102(a)(23) (2011).

second painter, however, who *also* seeks to sell a similar painting for money, falls outside the scope of Article 9, and, therefore, she does not have to conform to Article 9's strict filing requirements.[151] The purpose of requiring consignors of non-consumer goods to conform to the Article 9 requirements is based on the idea that those who seek to sell consumer goods should not be required to conform to complex secured lending requirements under Article 9, but those who seek to sell non-consumer (commercial) goods should.[152]

VI. THE 2001 REVISIONS LEAVE ARTISTS AND OTHER CONSIGNORS OF ART WORSE OFF

A. *Courts Misinterpret the UCC's Unclear Treatment of Consignments*

The 2001 revisions sought to clarify the rights between consignors and consignee's creditors by deleting all references to consignment from the Former UCC section 2-326 and treating *some* consignments as "Article 9 consignments.[153] Namely, despite the drafting history leading up to the adoption of the 2001 UCC revisions, the current UCC's language and comments fail to specifically address how non-Article 9 consignments should be treated. This lack of specificity has left the courts with the following question: how should the UCC treat consignments that fall outside Article 9's narrow definition of consignments? Namely, if either the consignment is of consumer goods,[154] or the otherwise Article 9 consignor can prove the "generally known" exception,[155] or the Article 9 consigned goods do not exceed $1,000 in value,[156] does Article 2 govern?[157] Or does the common law of bailments govern?[158] What happens to these "orphaned" consignments?

There are two main arguments regarding the treatment of non-Article 9 consignments to deem or not deem the transaction

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151 *See generally* U.C.C. § 9-102(a)(20), (23) (2011). This hobbyist-paint/collector's works *are* consumer goods. *See id.* § 9-102(a)(23).

152 *See In re* Haley & Steele, Inc., No. 051617BLS, 2005 WL 3489869, at *3 (Sup. Ct. Mass. Nov. 14, 2005) ("[A] typical consumer depositor of artwork with a consignee like Haley & Steele should not be required to comply with the complexities of secured lending under Article 9 of the Uniform Commercial Code in order to have protection from Haley & Steele's general creditors.").

153 *See* U.C.C. § 9-102(a)(20) (2011); *id.* § 2-326 (2011) (post-2001 UCC); *see also* U.C.C. § 2-326 (1990) (later amended in 2001 and 2003).

154 U.C.C. § 9-102(a)(20)(C) (2011).

155 *Id.* § 9-102(a)(20)(A)(iii).

156 *Id.* § 9-102(a)(20)(B).

157 The reader should recall that if Article 2 governs, then the consignor's claims to his goods will likely be subordinated to the claims of secured creditors of the consignee. *See* U.C.C. § 2-326(2)–(3) (2011) (post-2001 UCC).

158 Ludvigh v. Am. Woolen Co., 231 U.S. 522, 528–30 (1909).

as a "sale or return." On one hand, the answer seems clear in the drafting history of the 2001 UCC that non-Article 9 consignments should be governed by the consignor-friendly *Ludvigh* rule and the common law of bailments.[159] The Official Comments to section 9-109 state that Article 9 does not include "all 'true' consignments (i.e., bailments for the purpose of sale)."[160] Furthermore, the 2001 revisions deleted UCC section 2-326(3), which had overturned the common-law treatment of consignments and treated them as "sales or returns."[161] As discussed earlier, consignments were *deemed* to be treated as section 2-326(2) "sales or returns" under section 2-326(3), even though they were not *actually* "sales or returns."[162] Therefore, absent section 2-326(3), which had originally governed consignments before the 2001 revisions, non-Article 9 consignments should return to consignor-friendly common law treatment rather than Article 2 treatment. Indeed, the drafting history seems to demand this result:

> Because original Section 2-326(3) has been eliminated, most such [consignment] transactions will not qualify for sale-or-return status; that is, title to the goods will not pass and thus the consignee will not be a "buyer" as that term is used in subsection *(a)*. [T]hey will be governed by the common law of bailments and the question whether the goods are subject to the claims of the consignee's creditors must be resolved by reference to [the common law].[163]

This reasoning is sensible. There is no apparent reason why, for example, consumer goods consignors, who are likely less familiar with art-related law because they do not often sell on consignment as regularly as non-consumer goods consignors, should be governed by Article 2 (Sales). If a post-2001 consignment is governed by Article 2 (Sales), then the consignor in that transaction no longer has the opportunity to prove the pre-2001 Article 2 section 2-326(3) exceptions. Indeed, the Committee Recommendations leading up to the 2001 revisions are in accord: "[i]t is not reasonable to expect most natural

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159 *Id.* (stating the rule under the common law of bailments).
160 U.C.C. § 9-109 cmt. 6 (2011) (post-2001 UCC).
161 *Compare* U.C.C. § 2-326 (1990) (pre-2001 UCC) *with* U.C.C. § 2-326 (2011) (post-2001 UCC).
162 Before the 2001 revisions, UCC section 2-326 treated subsection (2) *actual* "sales or returns" the same way that it treated subsection (3) consignments that were statutorily deemed "sales or returns." U.C.C. § 2-326(2)–(3) (1990) (pre-2001 UCC). However, the consignments formerly treated as "sales or returns" and actual "sales or returns" are subtlety different. *See* Dusch, *supra* note 66.
163 Reporter's Notes, *supra* note 130, at 66.

persons who deliver their consumer goods to merchants for sale to deal adequately with Article 9's filing and priority rules."[164]

On the other hand, courts, as in *In re Morgansen's, Ltd.*,[165] argue that non-Article 9 consignments are governed by Article 2 as "sales or returns." Because courts assume that consignments, except those now within the purview of Article 9, have always been treated as "sales or returns," non-Article 9 consignments are still treated as "sales or returns." Although case law on the matter is limited, courts have continued to follow the approach that the court delineated in *In re Morgansen's*.[166] First, the court will analyze whether the consignment is an Article 9 consignment.[167] If not, then the court will determine whether the transaction is a "sale or return" under revised Article 2 section 2-326.[168] If the transaction does not fall under Article 2, then the common law principles of bailment apply.[169] The logic makes sense, but the consequences fail to pass rational muster. The drafters of the UCC could never have intended to allow Article 9 consignors of art—consignments of non-consumer goods, with a value greater than $1,000, for example,[170]— to protect themselves through the Article 9 filing requirements, while not allowing non-Article 9 consignors— for example, consignors of consumer goods—to be protected by the same filing requirements. The latter non-Article 9 consignors cannot adequately protect their interests because the consignment will be governed by Article 2 as a "sale or return," which automatically subordinates the consignor's claims to those of the consignee's secured creditors.

Accordingly, if either an Article 9 consignment for which a

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164 *See* PEB STUDY GROUP REPORT, UNIFORM COMMERCIAL CODE ARTICLE 9, § 25, at 187 (December 1, 1992).

165 *See In re* Morgansen's, 302 B.R. 784 (Bankr. E.D.N.Y. 2003) (holding that if a consignment is not an Article 9 consignment, then the court will see if the consignment constitutes a "sale or return" under section 2-326 and if not, then the court must analyze the transaction under the common law of bailments).

166 *See, e.g.*, *In re* G.S. Dist., Inc., 331 B.R. 552 (Bankr. S.D.N.Y. 2005); *In re* Downey Creations, L.L.C., 414 B.R. 463 (Bankr. S.D. Ind. 2009); *In* re Music City RV, L.L.C., No. 08–07724, 2009 WL 77248, at *2 (Bankr. M.D. Tenn. Jan. 5, 2009):

> The Uniform Commercial Code has always dealt with consignments as sales under § 2-326. Under § 2-326(b) goods that are held on a "sale or return" basis are deemed to be subject to the claims of creditors, and hence, the priority scheme set forth in Article 9 (dealing with perfections of interests) applied. However, the revisions to the UCC added provisions into Article 9, dealing with consignments. One of the purposes of the revisions of the UCC was to cover some (but not all) of the consignment issues directly under Article 9 . . . However, these revisions did not remove all consignment situations from Article 2, because the definition of "consignment" in § 9-102(20) is restrictive, and does not cover all forms of consignments. In situations where a transaction does not fit within that definition, the former provisions of § 2-326 still apply.

Id. (citing Brief for the Appellant).

167 *See In re Morgansen's*, 302 B.R. 784.

168 *See id.*

169 *See id.*

170 *See* U.C.C. § 9-102(a)(20) (2011).

consignor can prove the "generally known" exception or a non-Article 9 consignment is present, then the would-be-"consignment" is deemed a "sale or return" under Article 2. The result of deeming the non-Article 9 consignment as a "sale or return" leaves the consignor as an unsecured creditor, whose claims to the consigned goods are subordinated to the claims of the consignee's secured creditors.

B. *Illustrating the Problem*

With the courts' analysis, there are two main reasons why art-consignors are worse off now than they were before the 2001 revisions: (1) "Article 9" consignments exclude "consumer goods," which the pre-2001 UCC section 2-326 did not exclude and (2) courts have relegated to Article 2 all non-Article 9 consignments, including consumer good consignments, ("Orphan Consignments"), which after the 2001 revisions no longer contain exceptions for transactions treated as "sales or returns" under the Former UCC.

1. Consignments of Consumer Goods

Remember that consumer goods, as defined in post-2001 UCC section 9-102(a)(23), are "goods that are used or bought for use primarily for personal, family, or household purposes"[171] and are specifically excluded from consignments under revised Article 9.[172] Before the 2001 revisions, consignors of consumer goods—for example, any good that was used for non-commercial reasons immediately before delivery to the consignee[173]—were treated the same by the Former UCC as consignors of non-consumer, or commercial, goods. Therefore, before the 2001 revisions, the consumer-consignor and the non-consumer consignor had equal rights vis-à-vis the consignee's creditors.[174] After the 2001 revisions, however, the non-consumer good consignor *must* adhere to the stringent Article 9 requirements to perfect the transaction as a purchase money security interest ("PMSI") in order to obtain priority over all other secured (and unsecured) creditors' claims

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171 *See id.* § 9-102(a)(23) (2011).
172 *See id.* § 9-102(a)(20) (2011).
173 *See In re* Haley & Steele, Inc., No. 051617BLS, 2005 WL 3489869, at *3 (Sup. Ct. Mass. Nov. 14, 2005) (stating that "'consumer consignors'—as opposed to 'commercial consignors'—are persons whose goods consisted of artwork that was used or bought for use primarily for personal, family, or household purposes immediately before delivery to [the consignee]. . . "); *see also* U.C.C. § 9-102(a)(20)(C) (2011) (noting the requirement that a consignment for UCC purposes excludes consignments of consumer goods).
174 See U.C.C. § 2-326 (1990) (pre-2001 UCC), for statutory text of pre-2001 UCC section 2-326, making no distinction between consumer good consignors and commercial good consignors.

to the consigned goods.[175]

To illustrate the problem, compare Artist with Art Collector. Artist produces a painting for sale, and *never* uses the work *primarily* for personal, family, or household purposes before delivering the work to the consignee for purposes of sale. Meanwhile, Art Collector buys a sculpture produced by the same Artist to display in Art Collector's home. Art Collector, having no expertise on how to sell art, flips through the Yellow Pages to find an art dealer. It turns out that both Art Collector and Artist have consigned their works to the same art dealer for purposes of sale (and both works were produced by the same artist). Pursuant to the consignment arrangement, both Artist and Art Collector hold title to their works and only transfer possession of the works to the art dealer for purposes of sale. Based on the facts so far, and assuming that the transaction takes place in 1999, the goods would be classified as a "sale or return" and would be subject to the claims of the consignee's creditors unless the consignor meets one of the three exceptions provided in Former UCC section 2-326(3).[176] Accordingly, neither Artist nor Art Collector would have protection against the claims of the consignee's creditors unless the consignors:

(1) posted an appropriate sign on their goods;[177]

(2) could successfully argue that the consignee's creditors generally know that the consignee is substantially engaged in selling consigned goods;[178] or

(3) filed an Article 9 financing statement.[179]

After the 2001 revisions, however, Artist, or any other consignor of *non-consumer* goods, *must* perfect her interest in the consigned goods in conformance with Article 9 or otherwise subvert her interest in the consigned goods to the claims of the consignee's creditors *unless* the consignor can establish that the consignee's creditors generally know that the consignee is substantially engaged in selling consigned goods.[180] If Artist *can* successfully establish the "generally known" exception, then Artist is left to the mercy of the courts (as discussed in the next section). Art Collector will also be at the mercy of the courts because she

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175 *See* U.C.C. § 9-324 (2011) (post-2001 UCC).
176 *See* U.C.C. § 2-326(3) (1990) (pre-2001 UCC).
177 *See id.* § 2-326(3)(a) (1990) (pre-2001 UCC) (the "sign posting exception").
178 *See id.* § 2-326(3)(b).
179 *See id.* § 2-326(3)(c) (1990) (pre-2001 UCC).
180 *See* U.C.C. § 9-102(a)(20)(A)(iii) (2011) (post-2001 UCC). This language preserves the exception under Former UCC section 2-326(3)(c) (1990) (pre-2001 UCC).

automatically falls outside the scope of revised Article 9[181] and the courts will treat the consignment as an Article 2 "sale or return."

2. Other "Orphaned" Consignments Subordinate Consignors' Claims to Those of Secured Creditors

To further illustrate the problem for "orphan" consignments, consider the example of Artist and Art Collector once again. After the 2001 revisions, and given the unique "hand-shake" culture of the art-market,[182] the Artist will typically *not* want to have her consignment transaction fall under Article 9. This is simply because we assume that most artists do not conform to the filing requirements that consignors must meet in order to perfect their consignment.[183] As noted earlier, the Artist with an Article 9 consignment may still argue that the "generally known" exception applies to the transaction, therefore causing a court to analyze whether the transaction is a "sale or return" under Article 2. Art Collector, because her consigned goods are consumer goods, is automatically excluded from the Article 9 financing statement requirements. In either case, Artist and Art Collector are even more disadvantaged after the 2001 revisions than before for two reasons. First, even if the transaction is deemed a "sale or return," the consignors can no longer argue *any* of the exceptions under Former UCC section 2-326 because those exceptions no longer exist under Article 2. Second, if a court deems that the transaction is a "sale or return," then the consignors' claims to the consigned goods *to which they hold title*—goods they *own*—are *automatically subordinated* to the claims of the consignee's creditors. The only remaining hope that non-Article 9 consignors have is that the court will deem the consignment to be outside the scope of Article 2—that is, that the consignment is not one that is a "sale or return."[184] But such a result is unexpected. Courts assume that because Article 2 section 2-326 has *always* treated true consignments as "sale or return" transactions,[185] non-Article 9 consignments will be treated as "sale or return" transactions even though this result goes against the intent of the UCC's drafting

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181 See U.C.C. § 9-102(a)(20) (2011), which excludes consumer-consignors from the protections afforded consignors under revised Article 9.

182 *See supra* notes 18–25 and accompanying text (discussing how art consignments would likely not occur if a party to a consignment requested a UCC financing statement filing).

183 *Id.*

184 *But see supra* notes 64–65 and accompanying text (discussing how most consignments will be deemed "sale or return").

185 *See* PEB STUDY GROUP REPORT, *supra* note 164, § 25, at 185 ("Section 2-326 . . . creates a dichotomy between "sale or return" transactions in which goods are delivered to a buyer for resale to third parties, and certain [true consignments]. The latter are "deemed to be on sale or return," with the consequences that the good are subject to the claims of the dealer's creditors.").

committee.[186]

If Artist, alternatively, *did* file a financing statement for her Article 9 consignment, then she is protected. Art Collector, however, *has no opportunity to file a financing statement* solely because her goods are "consumer goods," which are excluded from Article 9. Interestingly, even assuming that the parties have the same legal and business sophistication to know about UCC requirements and the filing of financing statements, Art Collector is left with no protection against the claims of the consignee's creditors *unless* a *court*[187] determines that the transaction is one that is not a "sale or return."

After the 2001 revisions, sophisticated consignors want their consignments to be Article 9 consignments because then they may adequately protect their interests if they properly file a financing statement and meet other notice requirements.[188] Second, the art-consignor, who is most often unaware of Article 9 requirements,[189] is almost automatically unprotected if the consignment is an Article 9 consignment *even if* the consignor can establish the "generally known exception."[190] Third, the art-consignor who falls outside the scope of Article 9, or, alternatively, who would fall within Article 9 had she not proved her consignment out of Article 9 through the troublesome "generally known" exception, will attempt to argue in *court* that the consignment is one that is *not* a sale or return. Such a consignor would want to argue that the consignment is not a sale or return because "sale or return" consignments automatically subvert the consignor's interest in consigned goods to the claims of the consignee's secured creditors.[191] Essentially, the only hopes for art-consignors who are unaware of Article 9 (or whose consignments fall outside the scope of Article 9) is for the court to deem the transaction as one for which a state statute affords the art-consignor special protection—but, of course, absent Article 2 section 208's applicability,[192] the creditors may still argue that the statute is ineffective because it inadequately repeals sections of the UCC

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186 *See supra* text accompanying notes 159–63 (discussing how the drafting history of the 2001 UCC revisions intended the UCC to govern non-Article 9 consignments according to the common law).

187 I frequently emphasize "court" because if the transaction falls outside Article 9 in either the pre-2001 UCC or post-2001 UCC, the consignor must involve himself in costly litigation to even have a chance at prioritizing his claim to his *owned* consigned goods against the claims of the insolvent consignee's creditors.

188 *See supra* notes 89–97 and accompanying text (delineating the notice and finance statement requirements under revised Article 9).

189 *See supra* Part I. B (discussing the "uniqueness" of the art market).

190 *See* U.C.C. § 9-102(a)(20) (2011) (post-2001 UCC); *see also* U.C.C. § 2-326 (1990) (pre-2001 UCC).

191 *See* U.C.C. § 2-326 (2011) (post-2001 UCC).

192 *See supra* note 119 and accompanying text.

under the section 1-104 "Repealer Provision."[193]

VII. PROPOSED REVISIONS TO THE UCC

The difficulty in proposing UCC revisions that would protect art-consignors is not readily apparent. The revisions must balance protecting art-consignors who (1) would be unaware, generally, of the UCC filing provisions, or (2) who may be aware of the UCC filing provisions but refuse to file because such a filing would constitute an "insult" to the art consignment agreement.[194] The UCC must provide such protections all while protecting creditors against "hidden liens." Such difficulty is evidenced by the numerous proposals to amend the Former UCC.[195]

To address the sudden disparate treatment between Article 9 consignments and non-Article 9 consignments (e.g., consignments of consumer goods), the UCC must explicitly address the following questions: does the UCC govern consignments that do not meet the restrictive Article 9 definition of consignment? If so, how should the law govern non-Article 9 consignments? The most effective proposal will address the three following failures:

> (1) Article 9, while governing consignments with an aggregate value greater than $1,000, does not govern consignments with an aggregate value of less than $1,000, which, because of ambiguity as to the applicability of Article 2 to the consignments with aggregate values less than $1,000, may permit courts to apply Article 2 to the transaction. The result of applying of Article 2 affords the consignor no opportunity for protection against the consignee's creditors.
>
> (2) Consumer goods, by not being governed by Article 9, leave courts confused as to whether Article 2 should apply to a transaction that would otherwise be an Article 9 consignment but for the consignment being one of consumer goods. Consignors of consumer goods, although less likely to conform to Article 9 filing requirements, should be afforded protection either conforming to Article 9 requirements otherwise available for non-consumer good consignments or by making Articles 2 and 9 inapplicable to the transaction.
>
> (3) The UCC does not address Consignments, as defined in Article 9, for which the consignor can prove the "generally known" exception. If the consignor proves the

193 For a discussion of the "Repealer" problem, see *supra* notes Part IV.B.
194 *See supra* notes 19–25 and accompanying text (discussing how UCC financing statements are insulting in the art market).
195 *See generally* Marcone, *supra* note 4, at 609–16.

> "generally known" exception, then courts should not be permitted to apply Article 2 to the transaction because of the obvious inequity: the consignor proves that Article 9 does not apply to the consignment through the generally known exception; the result of the exception is that the consignor does not need to meet the Article 9 filing requirements; furthermore, if the consignment is then deemed to be an Article 2 "sale or return," proving the "generally known" exception would be unavailing because "sale or return" transactions automatically subvert the "consignor's" interest to those of creditors; the final result is that by proving the "generally known" exception, the consignor may be proving his consignment into the hands of the consignee's creditors.

I offer two proposals to address how the UCC should govern, or not govern, true consignments that fall outside the scope of Article 9.

One proposal could be to amend section 9-102(20) as follows (the underlined text is *new* proposed language):

> (20) "Consignment" means a transaction, regardless of its form, in which a person delivers <u>goods</u> to a merchant for the purpose of sale and:
>
> (A) the merchant:
>
> (i) deals in goods of that kind under a name other than the name of the person making delivery;
>
> (ii) is not an auctioneer; and
>
> (iii) is not generally known by its creditors to be substantially engaged in selling the goods of others;
>
> (iv) <u>if the requirements of this subsection are not met, then the Uniform Commercial Code shall not govern the transaction</u>.
>
> (B) with respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery; <u>if the aggregate value of the goods is less than $1,000 at the time of delivery, then neither Article 9 (Secured Transactions) nor Article 2 (Sales) shall apply</u>.
>
> (C) the goods are not <u>consumer goods</u> immediately before delivery; <u>if the goods are consumer goods immediately before delivery, then this Article shall apply if the person delivers goods to a merchant for the purpose of sale and the merchant meets the requirements of subsection (A);</u> and
>
> (D) the transaction does not create a security interest

that secures an obligation.

The above changes address two problems of the post-2001 UCC. First, by adding "if the aggregate value of the goods is less than $1,000 at the time of delivery, neither Article 9 (Secured Transactions) nor Article 2 (Sales) shall apply" to section 9-102(20)(B). By excluding consignments with an aggregate value of less than $1,000 from Article 9, the drafters of the UCC presumably concluded that *immaterial* consignments—that is, consignments with less than an aggregate value of $1,000—should not have to conform to the stringent Article 9 requirements to protect the consignor's interest in the consigned goods.[196] It follows that if it is too burdensome for consignors of an immaterial value of goods to conform to Article 9 to protect their consigned goods, than such consignors should be afforded *per se* protection against the consignee's creditors. Unfortunately, without clarifying the treatment of "immaterial" consignments, courts may apply Article 2 and deem the immaterial consignment as a "sale or return," which *automatically* subverts the consignor's interest in consigned goods to the claims of the consignee's secured creditors.

Second, I suggest adding "if the goods are consumer goods immediately before delivery, then this Article shall apply if the person delivers good to a merchant for the purpose of sale and the merchant meets the requirements of subsection (A)." This proposal affords consignors of consumer goods the same opportunity for protection as consignors of non-consumer goods. This additional language, or similar language, is necessary because there is no legal rationality to allowing consignors of non-consumer goods to perfect their interest while *disallowing* consignors of consumer goods to perfect their interest. As the statute currently reads, courts may apply Article 2 to consignments that would otherwise be Article 9 consignments but for the consignment being one of consumer goods. If consumer goods consignors cannot protect themselves under Article 9, then Article 2 should not automatically subvert the consignor's interest in the goods to that of an unsecured creditor.

Third, adding "if the requirements of this subsection are not met, then the Uniform Commercial Code shall not govern the transaction," will address how the UCC should govern, if at all, consignments that would be Article 9 consignments but for the consignor proving that the merchant is "not generally known by its

196 *See supra* note 130 (discussing the drafters' intent to exclude consumer goods from Article 2 and Article 9).

creditors to be substantially engaged in selling the goods of others." If the consignor proves the "generally known" exception, the consignor is attempting to *justify* her failure to conform to Article 9's filing requirements to perfect the interest in consigned goods. However, because the UCC does not explicitly address how it should govern consignments for which the consignor can prove the arduous "generally known" exception, courts may deem that Article 2 applies and identify the "consignment" as a "sale or return." After the 2001 revisions, however, "sale or return" transactions automatically subvert the "consignor's" interest in consigned goods to the claims of the consignee's creditors. This should not be the case. If the consignee's creditors generally know that the consignee deals in consigned goods, then such creditors should not be surprised by "hidden liens" in consigned goods. Therefore, Article 2 should not govern such a consignment, and the proposed language addresses that issue.

Another proposal, with the *same* results, but with *fewer* amendments, is to amend section 2-326, rather than section 9-102(a)(20), as follows (the underlined text is *new* proposed language):

> (1) Unless otherwise agreed, if delivered goods may be returned by the buyer even if they conform to the contract, the transaction is:
>
> (a) a "sale on approval" if the goods are delivered primarily for use; and
>
> (b) a "sale or return" if the goods are delivered primarily for resale.
>
> (2) Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.
>
> (3) Any "or return" term of a contract for sale is to be treated as a separate contract for sale under Section 2-201 and as contradicting the sale aspect of the contract under Section 2-202.
>
> (4) This section shall not apply to any Consignment, as defined in Article 9, which would otherwise be a Consignment but for subsection(s) (A)(iii), (B), or (C) of Section 9-102(20).

The results are substantially the same as the first proposal. The benefit of this proposal over the first proposal is that this second proposal explicitly exempts consignments of consumer goods, consignments whose aggregate value is less than $1,000,

and consignments that would otherwise be Article 9 consignments but for the consignor successfully proving the "generally known" exception, from Article 2 *within the language of Article 2*. This would leave no ambiguity as to Article 2's applicability to certain consignments, which is an issue with which some courts have struggled.[197]

VIII. CONCLUSION

Prior to the 2001 revisions to the UCC, all consignments were governed by UCC section 2-326 as "sales or returns," which provided exceptions that consignors of art may seek to prove to protect their interest in consigned goods against the potential claims of the consignee's secured creditors. Under those exceptions, consignors could protect their interests in consigned goods by either (1) arguing in court that the consignee's creditors generally knew the consignee to substantially deal in consigned goods, (2) posting a sign on their consigned work that clearly identified that the work is consigned and not owned by the dealer, or (3) filing a UCC financing statement.

After the 2001 revisions, the exceptions—the financing statement notwithstanding—no longer exist. Rather, the Code included the former *generally known to deal in consigned goods* exception within the new Article 9 definition of consignments. But many consignments are "orphaned" from the UCC because they do not fit within the Article 9 definition of consignment, and they are no longer expressly governed by Article 2—or any other UCC provision. For example, if the good is a consumer good—meaning that the work was used for personal or decorative purposes immediately before consignment—or if the good is worth less than $1,000, or if the creditors generally know the dealer to sell consigned goods, then the consignment is not an Article 9 consignment. Accordingly, many such orphaned consignments are deemed to fall under Article 2 as a "sale or return." But this is improper; that courts find that non-Article 9 consignments fall under Article 2 as "sales or returns" is contrary to the drafters' intent, as well as inequitable. Indeed, this Note argues that non-Article 9 consignments should not default to Article 2. Revised Article 2, however, no longer allows a non-Article 9 consignor to protect her interest in consigned goods where a court deems the consignment to default to Article 2, because revised Article 2 deleted the exceptions that provided an opportunity for a consignor to protect her interest against the claims of the consignee's creditors. This result for orphan

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197 *See generally In re* Morgansen's, 302 B.R. 784 (Bankr. E.D.N.Y. 2003).

consignments must be an unintentional drafting error.

To address the problems of the Revised UCC and the orphaned consignments, this note proposes to amend the statutory language of either Article 2 or Article 9. These proposals seek to accommodate the creditor's reasonable reliance on the inventory in the consignee-debtor's possession, while providing for protection of non-Article 9 consignments—those that are either immaterial in value or involve consumer, rather than commercial, consignors, who should not be subject to the strict filing and notice requirements of Article 9. These proposals also seek to accommodate consignors of art, whose "handshake" art culture often discourages written contracts and Article 9 notice filings.

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[*] Articles Editor, Cardozo Arts & Ent. L. J. (2011–2012), J.D. Candidate, Benjamin N. Cardozo School of Law (2012); B.S., M.B.T., University of Southern California (2008, 2009). I would like to extend many, many thanks to my Mother, Father, and four brothers for their limitless love and for making me who I am; Caroline Glickler, Aleks Gelerman, and Sarah Nadeau for their phenomenal editing prowess; and Professor Paul Shupack for his steadfast guidance with this Note. I would also like to thank my friends and colleagues who have supported me. I dedicate this Note to the late Phineas Leahey whose kindness and abilities continue to inspire me.