THE UCC AND CONSIGNMENT: MAKING THE CODE SAFE FOR ARTISTS AND OTHER "LITTLE FELLOWS"*

I. INTRODUCTION

Consignment, which is one means of delivering goods to another for sale, has long been a thorny issue in commercial law. While the law governing the adjudication of claims that arise between consignors and consignees is well-settled, the resolution of competing claims to goods becomes problematic when the competing claimants to those goods are the owner and either unsecured creditors of the consignee or secured creditors to whom the consignee wrongfully granted a security interest. Against each of these claimants, the owner will assert that the creditor had no right to treat these goods as collateral. In response, a secured creditor will respond that he had a right to rely on the dealer's possession of the goods as evidence of ownership and was entitled to advance credit on the strength of that possession, and, since the loan is in default, that he has the superior claim to the goods. In a bankruptcy proceeding both secured and unsecured creditors will insist that the consignor not take the goods ahead of creditors, but take according to the priority rules of the Bankruptcy Code and Article 9.

The Uniform Commercial Code ("Code" or "UCC"),[1] by means of Section 2-326 and related provisions, purports to manage such disputes.[2] Section 2-326 narrowly defines the rights of con-

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[1] The Uniform Commercial Code is the product of the joint effort of the American Law Institute and the National Conference of Commissioners on Uniform State Laws to condense a range of unwieldy state laws governing commercial transactions into a single, unified body of law. Work on the project began in the 1940s. The first official text of the Code was enacted in Pennsylvania in 1954. Since then, all states except Louisiana (which has adopted certain articles) have adopted a version of the Code. Although adopted by the individual states, the UCC stands as a cohesive body of law with a national scope (Congress, although it has enacted the Code for the District of Columbia, has not enacted the Code as general federal commercial law). *See* 1 HAWKLAND, UNIFORM COMMERCIAL CODE SERIES §§ 1-101:02, 1-103:02 (1992).

[2] UCC § 2-326 states:

SALE ON APPROVAL AND SALE OR RETURN; CONSIGNMENT SALES AND RIGHTS OF CREDITORS.

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though 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) Except as provided in subsection (3), goods held on approval are not sub-

signors, and will typically permit a consignee's creditors to take goods free of the owner's interest. The doctrine of ostensible ownership, as well as good faith purchase, which form the backdrop of the Code's treatment of creditors' rights, govern such results.[3] According to the ostensible ownership doctrine, a creditor may rely on possession of the goods by his debtor (here the consignee) as an indication of the debtor's ownership of the goods.[4] Hence, when 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,[5] or indirectly subverted to the unsecured creditor's interest in the goods, who must rely on a judgment creditor's remedies.[6] Only a consignor able to take advantage of certain exceptions provided by Section 2-326 will find shelter from the consignee's creditor, whether such creditor is secured or unsecured.[7]

The disadvantages of such a scheme are most easily seen in the art market, where both the culture of the art world and the commercial nature of the art market work to the detriment of the artist/consignor. Because artists rely on the honesty of art dealers and typically remain unaware of the mandates of the Code, they will lose their works of art to creditors if the dealer goes bankrupt. The plight of the artist has been recognized by a majority of state

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ject 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).

(4) 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 (1990).

[3] *See infra* note 155.

[4] *See infra* note 155.

[5] U.C.C. art. 9, pt. 5 (1990); U.C.C. §§ 9-114(2), 9-301 (1990). *See also* E. ALLAN FARNSWORTH ET AL., CASES AND MATERIALS ON COMMERCIAL LAW 745 (1993).

[6] FARNSWORTH, *supra* note 5, at 745.

[7] *See infra* notes 116-28 and accompanying text.

legislatures, including those of New York and California, which have enacted legislation that provides artists greater protection from a dealer's creditors than that which is provided by the Code.[8] However, many of these statutes are poorly drafted and so fail to adequately protect the art consignor against a consignee's creditors.[9]

As a remedy for the poor performance of these statutes, one could undertake a state-by-state effort directed toward the individual state legislatures to either amend their versions of the Code or their non-uniform legislation. However, a general revision of Article 2, under the aegis of the National Conference of Commissioners on Uniform State Law, is now in progress. As part of the continuing process, both the Article 2 Study Group and the Article 9 Study Committee have made suggestions for revision of Section 2-326,[10] some of which have been fashioned into a preliminary draft by the Article 2 Drafting Committee.[11] This Note recommends that the revisors take another look at Section 2-326, and incorporate into that section greater protection for artists, and extend that protection to other types of consignors.[12]

The Article 2 Study Group, Article 9 Study Committee, and the Article 2 Drafting Committee each profess to support measures to increase protection for certain consignors. However, while some of the proposed revisions would increase protection for consignors, others would decrease or eliminate what little protection is currently available under the UCC or would be available under a

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8 *See infra* part II.C.

9 *See infra* part II.C.

10 *See infra* notes 171-72, 174-77 and accompanying text.

> In early 1990, the Permanent Editorial Board for the UCC ("PEB"), with the support of the American Law Institute ("ALI") and the National Conference of Commissioners on Uniform State Laws ("National Conference") established . . . [the Article 9] Study Committee . . . [and] charged [it] with reporting whether Article 9 and related provisions are in need of revision. . . . [I]f it concluded that revision is desirable, to recommend the nature and substance of such revisions.

PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PEB STUDY COMMITTEE: UNIFORM COMMERCIAL CODE, ARTICLE 9: REPORT (DECEMBER 1 1992) 1 (1992) [hereinafter ARTICLE 9 REPORT].

For more detail on the relationship between the ALI and the Conference, the Article 9 Study Committee, see *Agreement Describing the Relationship of the American Law Institute, the National Conference of Commissioners on Uniform State Laws, and the Permanent Editorial Board with Respect to the Uniform Commercial Code* (July 31, 1986), *in* AMERICAN LAW INSTITUTE, 64TH ANNUAL MEETING AMERICAN LAW INSTITUTE PROCEEDINGS 1987, 769, 772-75 (1988).

11 UNIFORM COMMERCIAL CODE § 2-327 (Tentative Draft 1993) [hereinafter ARTICLE 2 DRAFT]. *See infra* note 178 for proposed text.

12 Such an extention would help to account for the interests of those in the diamond trade (*see infra* note 22 and accompanying text) as well as in the cattle business (*see infra* note 135 and accompanying text).

revised Section 2-326.[13] Of primary concern is the recommendation by both the Article 2 Study Group and Article 9 Study Committee that Section 2-326(3)(b) (hereinafter the "generally known" exception) of the Code—which presently provides that an owner of goods prevails over any creditor when the consignee's creditors generally know that the consignee substantially deals in the goods of others—be limited to auctioneers.[14]

The Article 2 Drafting Committee has acted upon the recommendations of both the Article 2 Study Group and the Article 9 Study Committee, entirely deleting the provision providing protection against secured creditors when the consignee's creditors generally know that the consignee substantially deals in the goods of others in the proposed draft of Section 2-326, while retaining an auctioneer exception.[15]

For purposes of organization, this Note is divided into several parts. First Part II will summarize the current status of consignment law. A consignment is different from either a sale or a security interest, and courts have traditionally treated consignments differently from these transactions. After discussing the legal nature and commercial utility of consignment, Part II, Section B narrows its focus to art consignment, discussing the peculiar nature of the art market and the dismal Code treatment of this area. The combination of these two factors influenced the widespread state response to the plight of the artist-consignor. Section C of Part II will discuss the enactment of the state art consignment statutes, and demonstrate that these statutes, although well-intentioned, are often poorly drafted, and frequently provide artists with no greater protection than does the Code. Furthermore, the section will demonstrate that many of the statutes are vulnerable to attack under the UCC Article 1 repealer provisions.[16]

Part III compares the common law and Code treatment of consignments, highlighting how common law courts—with greater leeway to consider the intentions of the consignor as well as the rights of creditors and the actions of the consignee—could and did differentiate between consignment and security transactions, affording either consignors or creditors protection when the facts so merited.[17] Aside from the fact that consignors stood a much better chance of prevailing over creditors under common law, common

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13 *See infra* notes 171-72, 174-77 and accompanying text.
14 *See infra* note 171.
15 *See infra* note 177.
16 *See infra* note 61 and accompanying text.
17 *See infra* part III.A.

law courts were in a position to place greater weight upon an owner's actions and state of mind, and to balance those actions and intentions against the actions of the creditor. Although the Code places greater restrictions on Code courts' ability to take into account the considerations that mattered to common law courts, Code courts continue, in some circumstances, to evade Code restrictions by means of strained readings of the Code.[18]

Part IV addresses these courts' attempts to read into Section 2-326 more protection for consignors than a literal reading of the section allows. The theme of this section is not that these courts are simply misinterpreting the Code, but that they are attempting to satisfy fact patterns not adequately accounted for by the language of the provisions. These courts react not only to the type of consignor, but to the state of mind of the creditor. Where creditors have, or should have, knowledge of the consignment transaction, these courts, in an attempt to reach a fair result, will find for the consignor at the expense of a fair reading of Code provisions.

In Part V, this Note recommends that the revisors of the Code reexamine the criticisms of the Code consignment provisions, and strengthen the protections available to consignors under Section 2-326: not only as a means of enhancing protection for artists, but to enhance protection for consignors in general. Specifically, creditors should not receive greater protection under a revised Section 2-326 than the Code consignment provisions currently afford them. Instead, the drafters should relax the emphasis placed on ostensible ownership doctrine and fashion a consignment rule which protects the type of owner and the type of consignment of goods that courts are willing to protect, and should fashion a rule that treats creditor behavior with the same scrutiny that the courts are willing to apply. Such revision should include: (1) the addition to the Code of a definition or clarification of consignment; (2) the creation within Section 2-326 of an exception for natural persons and consumer goods; and (3) the retention, if not expansion, of Section 2-326(3)(b) to make creditors more responsible for knowledge of consignment transactions.[19]

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[18] *See infra* part IV.

[19] Suggestion (1) is consistent with both the Article 9 Study Committee and the Article 2 Study Group. Suggestion (2), the natural persons exception is supported by the Article 9 Study Committee, while the Article 2 Drafting Committee has opted for the consumer goods exception. Suggestion (3) contrasts not only with the recommendation of the Article 2 Study Group and Article 9 Study Committee, but with the draft submitted by the Article 2 Drafting Committee.

II. CONSIGNMENT

A. *The Consignment Transaction*

The consignment of goods for sale is, at first blush, a fairly simple and useful tool for both the owner/consignor and the consignee. The owner of goods transfers possession of the goods to the consignee, who will then attempt to sell the goods to third parties (usually for a percentage of the sale price).[20] Should the consignee fail to sell the goods, he simply returns them to the owner. The consignee is under no obligation to pay for the goods unless they are sold.[21] Often, such a transaction is the most appropriate way to distribute goods for sale.[22] For example, "if business conditions are poor, the only way in which a manufacturer is able to induce a distributor or dealer to take his product is through some transaction under which the deliveree assumes a minimum of risks."[23] Consignment is also the best way for a manufacturer who wants to market a new, untested, or unique product to attract distributors or dealers. Consignment provides the incentive for the dealer to deal in the goods by eliminating risk of loss.[24]

Of course, the above considerations do not rule out the use of a security interest by the consignor.[25] Section 2-326(3)(c) provides

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[20] *See* Baykam v. Martin/Molinary Art & Design Galleries, Ltd., No. 86 Civ.1010, 1987 U.S. Dist. LEXIS 5714 (S.D.N.Y. June 26, 1987). *See also* 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 3.5, at 73-74 (1965):

> Under a "true" consignment, the owner of goods delivers them to a consignee for sale. If the consignee sells them, he must account to the owner-consignor for the proceeds of sale less his commission. If he does not sell the goods, he must return them, but he does not in any case become liable to the consignor for the price of the goods if they are not sold. Title to the goods remains in the consignor during the consignment and passes, when the goods are sold, directly to the purchaser.

Id.

[21] GILMORE, *supra* note 20, § 3.5, at 74-75.

[22] *See* U.C.C. § 2-326 cmt. 1 (1990) (noting utility of "sale or return" transactions in accommodating merchant's unwillingness to buy goods); Richard Duesenberg, *Consignment Distribution Under the Uniform Commercial Code: Code, Bankruptcy and Antitrust Considerations*, 2 VAL. U. L. REV. 227, 237-41 (1968) (outlining various commercial situations in which consignment is the optimal solution for both owners' and dealers' needs) [hereinafter Duesenberg, *Consignment Distribution*]; Richard Duesenberg, *Consignments Under the UCC: A Comment on Emerging Principles*, 26 BUS. LAW. 565 (1970); Frank J. Miele, *Tension Between Trade Practices and Entrusting Rules Keep Art Dealers on Their Toes*, N.Y. L.J. July 25, 1986 at 5 (discussing practicality of consignment in consideration in diamond and art market); Leonard Weiner, *The Diamond Industry's Dilemma: UCC Consignment Provisions*, 17 UCC L.J. 99 (1984).

[23] *See* Duesenberg, *Consignment Distribution*, *supra* note 22, at 237.

[24] *See* Consolidated Accessories Corp. v. Franchise Tax Board of the State of California, 208 Cal. Rptr. 74, 78 (Cal. Dist. Ct. App. 1984) (Consignment arrangement allows the consignor the "ability to set the price for the retail goods[,] and [for] the distribution of goods to otherwise reluctant retail stores by relieving the retailer of the obligation to pay for goods unless sold and by offering the retailer the right to return any goods not sold.").

[25] UCC § 1-201(37) defines a security interest as an "interest in personal property or

that if the consignor files a security agreement, pursuant to Section 9-114, the consignor's goods are not subject to the claims of the consignee's creditors.[26] By its terms, such an agreement closely parallels the purchase money security interest, and is enforceable as such.[27] When, through oversight or otherwise, the consignor does not file such a security interest,[28] the consignor's interest is not signalled to the consignee's creditors. In this situation, when the consignee runs into financial difficulty and cannot pay the purchase price, the owner, who has an unperfected interest in the goods, may attempt to avoid creditors' claims to the goods in a consignee's possession by employing the trappings of consignment.[29]

Courts understand that this sort of behavior occurs and thus do not depend on the owner's characterization of the agreement as a consignment transaction, but determine whether the owner and transferee intended a consignment based upon an objective analysis of the substance of the agreement.[30] If, upon examina-

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fixtures which secures payment or performance of an obligation." U.C.C. § 1-201(37) (1990).

[26] *See infra* note 125.

[27] U.C.C. § 2-326(3)(c).

> UCC § 9-107 defines a purchase money security interest as a
> security interest . . . to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

U.C.C. § 9-107 (1990). *See also* Charles W. Mooney, Jr., *The Mystery and Myth of "Ostensible Ownership" and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases*, 39 ALA. L. REV. 683, 763 n.304 (1988); ARTICLE 9 REPORT, *supra* note 10, at 189.

[28] *See* U.C.C. art. 9, pt. 4 for a description of filing procedures.

[29] *See* Murphy v. Southwest Bank, 611 So. 2d 269 (Ala. 1992).

[30] *See* General Elec. Credit Corp. v. Strickland Div. of Rebel Lumber Co., 437 So. 2d 1240 (Ala. 1983). In *Strickland*, General Electric (GECC) entered into a financing agreement with one Terry, a dealer in metal buildings, in which GECC agreed to directly pay Strickland, the manufacturer, for metal buildings Strickland delivered to Terry. GECC took a security interest in all Terry's present and after-acquired inventory to ensure payment by Terry. Terry defaulted and GECC ceased paying Strickland and then sought to reclaim the buildings as collateral. Strickland, without the backing of GECC, then undertook to continue delivering goods to Terry under a "consignment" transaction. Terry would pay Strickland a 5% surcharge for each building delivered, whether or not sold. Meanwhile, Terry entered into a second arrangement with one Smith, another manufacturer, for Smith to deliver metal buildings on "consignment" to Terry. Smith was to pay Terry a commission for each building sold and Terry was under no obligation to pay for buildings he did not sell. *Id.* at 1242. The Court found that the 5% surcharge amounted to an unperfected security interest and held GECC's perfected security interest superior to Strickland's unperfected security interest and awarded the Strickland metal buildings to GECC. *Id.* at 1244-45. However, the court also found the second transaction, between Terry and Smith, to be a classic consignment. *Id.* at 1245. *See also* Minor v. Stevenson, 278 Cal. Rptr. 558 (Cal. Ct. App. 1991); Limor Diamonds, Inc. v. D'Oro By Christopher Michael, Inc., 558 F. Supp. 709, 711 (S.D.N.Y. 1983) ("Under the UCC, the intention of the parties is not determinative of the question whether a transaction is a sale or consignment.") (citing Bufkor, Inc. v. Star Jewelry Co., Inc., 552 S.W.2d 522, 524 (Tex. Civ. App. 1977)); Columbia Int'l Corp. v. Kempler, 175 N.W. 465 (Wis. 1970).

tion, a court finds that the terms of the transaction indicate that it is one of consignment, and not security,[31] the court then determines if the parties actually complied with such terms.[32] If so, then the transaction is deemed a consignment.[33] Otherwise, the owner's interest is considered an unperfected security interest, and a claim to the goods by way of such an interest is subordinate to that of the debtor's creditors.[34]

B. *Art Consignment*

When an artist wants to sell a painting, he brings it to either a dealer or an auction house—the actors best equipped to sell works of art.[35] Both art dealers and auctioneers typically accept consignments. Such an arrangement can benefit the little-known artist as well as the gallery, allowing the artist to exhibit the work and "giving the gallery the opportunity to 'test-market' the work without taking a tremendous financial risk that the work will not be popular among the art-purchasing public."[36] The art consignment allows the artist who is unhappy with a gallery's promotion of his works to retrieve his works and seek out other galleries.[37]

The artist and dealer agree, traditionally with a handshake, to a variety of conditions under which the dealer agrees to sell the

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[31] Code courts treating consignment questions often consider many of the same factors in characterizing the transaction as did courts which dealt with consignments under the common law. *See* Consolidated Accessories Corp. v. Franchise Tax Board of the State of California, 208 Cal. Rptr. 74, 78 (Cal. Dist. Ct. App. 1984); Hervey v. AMF Beaird, Inc., 464 S.W.2d 557, 562 (Ark. 1971); Liebowitz v. Voiello, 107 F.2d 914 (2d Cir. 1939); Reliance Shoe Co. v. Manly, 25 F.2d 381, 381 (4th Cir. 1928).

For example, the *Consolidated* court noted a number of indicia of the consignment transaction: (1) suggestion and contemplation of consignment in the memorandum of the agreement between the parties; (2) lack of obligation on the part of the "consignee" to pay for the unsold goods; (3) obligation of the consignee to pay for goods when sold by him; (4) prompt remittance to consignor for goods sold, whether for cash or credit; (5) visits to consignee to inquire into sales and urge prompt remittance of collections to consignor; (6) keeping by a representative of the consignor of an account or inventory of goods consigned and sold; (7) provision for return of merchandise upon termination of the agreement. *Consolidated*, 208 Cal. Rptr. at 77 (citing Hervey v. AMF Beard, Inc., 464 S.W.2d 557, 562 (1971)).

[32] Liebowitz v. Voiello, 107 F.2d 914 (2d Cir. 1939). Fowler v. Pennsylvania Tire Co., 326 F.2d 526, 532-35 (5th Cir. 1964) (dissent).

[33] *See* Duesenberg, *Consignment Distribution, supra* note 22, at 234-35.

[34] U.C.C. § 9-114(2). *See generally In re* Ide Jewelry Co., Inc., 75 B.R. 969 (Bankr. S.D.N.Y. 1987); *In re* Florida Consumer's Furniture Warehouse, Inc., 9 B.R. 7 (Bankr. S.D. Fla. 1981).

[35] *See* Patty Gerstenblith, *Picture Imperfect: Attempted Regulation of the Art Market*, 29 WM. & MARY L. REV. 501, 555-65 (1988) (discussing the diminishing distinctions between artist/auctioneer transactions and artist/dealer transactions, and the resulting practicability of creating single standard for dealings between owners and purchasers).

[36] Cathryn Mitchell Heise, *Florida's Art Consignment Statute: A Trap for the Unwary Artist?*, 14 NOVA L. REV. 473, 476-77 (1990) (citing FRANKLIN FELDMAN ET AL., ART LAW: RIGHTS AND LIABILITIES OF CREATORS AND COLLECTORS § 3.1.1 (1983)).

[37] *Id.* at 476.

painting.[38] Usually no papers are exchanged since "[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."[39] Some suggest that the idea of executing formal agreements for the consignment of art strikes artists as evidence of a lack of trust in a relationship too unique to be governed by a written contract.[40]

Despite, and often because of, the assumption of trust that often underlies art transactions, the personalized nature of the business has permitted unscrupulous dealers to abuse the trust that artists place in them.[41] Dealers occasionally have attempted to "undermine the principal-agent relationship [established by the con-

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[38] *See* RALPH E. LERNER & JUDITH BRESLER, ART LAW: THE GUIDE FOR COLLECTORS, INVESTORS, DEALERS, AND ARTISTS 7 (1989).

[39] *Id.*

[40] The courts look upon this sort of consignment, as well as consignment in general, as a form of bailment, creating an agency relationship. Agency may be defined as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act." THE RESTATEMENT (SECOND) OF AGENCY § 1 (1958). For a common law definition of this relationship, see *generally* Brown & Co. v. McGran, 39 S.C. 479 (1840); Ludvigh v. American Woolen Co. of New York, 231 U.S. 522 (1913); *In re* Galt, 120 F. 64 (7th Cir. 1903); Taylor v. Fram, 252 F. 465 (2d Cir. 1918). For more recent statements, see Manger v. Davis, 619 P.2d 687 (Utah 1980); *In re* Friedman, 407 N.Y.S.2d 999, 1006 (App. Div. 1978) (holding such an agency for art consignment); *see also* Duesenberg, *Consignment Distribution, supra* note 22, at 235. This agency relationship entails fiduciary duties which flow from the consignee to the consignor. Black's Law Dictionary states that a fiduciary relationship "arises whenever confidence is reposed on one side, and domination and influence result on the other; the relation can be legal, social, domestic, or merely personal." BLACK'S LAW DICTIONARY 626 (6th ed. 1990). The fiduciary himself is "a person holding the character of a trustee, or a character analogous to that of a trustee, in respect to the trust and confidence involved in [the position of the trustee] . . . and the scrupulous good faith and candor which it requires . . . . A breach of fiduciary responsibility would make the trustee liable to the beneficiaries for any damage caused by such breach." *Id.* at 625. As a fiduciary, the consignee has a duty to act in the best interests of the owner/consignor, and will be held accountable for the breach of that duty; such is the case with art consignment. *See In re* Friedman, 407 N.Y.S.2d 999 (App. Div. 1978) (discussing fiduciary relationship in context of art consignment); Britton v. Ferrin, 63 N.E. 954 (N.Y. 1902).

[41] LERNER & BRESLER, *supra* note 38, at 26 (noting that in New York, art dealers regularly took advantage of artists during the 1960's); *see also* Austin C. Wehrwein, *Artists Strangle in Bed of Roses, Aide of Guggenheim Tells Panel*, N.Y. TIMES, Apr. 16, 1965; Richard F. Shepard, *Artist or the Public: Who Needs the Protection?*, N.Y. TIMES, Dec. 29, 1965, at 31.

Friedman provides a glimpse of some of the more egregious practices of dealers during the 1960s. In 1963, Egan, an art dealer, negotiated with Renee, the seventy-five-year old widow of one Friedman for the transfer of Friedman's work to the dealer in a consignment arrangement. *Friedman*, 407 N.Y.S.2d at 1002. When Renee informed Egan that she could not afford representation in negotiations, Egan offered, and she accepted, his lawyer as counsel. Not surprisingly, the contract that was signed was highly unfavorable to Renee. The dealer held only one exhibition in 1969. In response to Renee's repeated inquiries about the status of Egan's efforts, Egan challenged the elderly woman, saying: "'Look. You can have the paintings and see what you can do.'" *Id.* at 1003. When Renee died in 1976, her estate demanded the return of the paintings and the dealer refused to do so (the paintings were valued at a half-million dollars at the time of trial). The court found for the estate applying principles of agency and unconscionability. *Id.* at 1005-09.

signment] and the fiduciary obligations inherent in that relationship by means of disguised purchase agreements and contractual waivers[, in order that] the relationship . . . resembles that of debtor and creditor."[42] In these circumstances, when the dealer will not pay the artist but refuses to return a work, the artist is limited to suit for contractual amounts due.[43] This may be an adequate remedy, if the artist is willing to sue and if the amount involved is worth the price of litigation. Even then, the contractual amount due may not equal the market value of the art lost to the artist.

The artist-dealer relationship is only one-half of the equation, however. The rights of the consignor as against the dealer's creditors are also often involved. At this point, Section 2-326 comes into play, defining the consignor's rights as against creditors.[44] According to Section 2-326, goods, here, the artwork, may be returned even though they conform to the contract. Hence, the transaction is deemed a "sale or return."[45] Further, according to Section 2-326(3), since the goods are being delivered for sale to a person who 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," the transfer is deemed a sale or return, even if the parties term the transaction a consignment.[46] Section 2-326(2) makes the art deemed to be on sale or return subject to the claims of the dealer's creditors while in the dealer's possession. However, according to the first clause of Section 2-326(2), if the owner complies with one of the three Section 2-326(3) exceptions, the transaction will not be governed by Section 2-326.[47] At this point, the Code ceases to govern the transaction, and the consignment is treated according to principles established by other state law.

Whereas in most commercial transactions, the parties involved are merchants or professionals in the business of extending credit and are, or should be, aware of the legal implications of the partic-

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42 *See* LERNER & BRESLER, *supra* note 38, at 26. For an explanation of the principal-agent relationship established by the consignment see *supra* note 40 and accompanying text.

43 *See* LERNER & BRESLER, *supra note* 38, at 26.

44 *See infra* note 2 for the text of § 2-326.

45 U.C.C. § 2-326(1)(b) (1990).

46 U.C.C. § 2-326(3).

47 U.C.C. § 2-326(2). These exceptions include (a) the posting of a sign according to an applicable sign law, (b) proving that creditors of the consignee generally know that the consignee is substantially engaged in dealing in the goods of others, or (c) filing according to Article 9. U.C.C. § 2-326(3)(a)-(c). See *infra* notes 116-28 and accompanying text for description and discussion of these exceptions.

ular transactional forms by which they do business,[48] the artist is not likely to be well-informed as to the legal ramifications of the consignment transaction. Additionally, artists usually consider the nature of the artist-dealer relationship much too personal to require formal measures of protection against dealers, let alone the dealer's creditors.[49] Where a dealer's creditors, which are frequently banks, will conduct their transactions with due respect for the Code and will take the proper measures to secure their interests,[50] artists frequently will not.[51]

C. *State Legislation*

Since the passage in 1966 of the first art consignment statute—a reaction to the inequitable treatment of artists under the prevailing consignment law—at least twenty-eight states have passed legislation designed to address the artist-dealer transaction and to define the rights and liabilities of artists, dealers, and creditors.[52] Two states, Alaska and Arkansas, have taken a bolder approach, writing exceptions for artists into their versions of the Code.[53] The intent of the statutes is to provide blanket exclusions

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[48] Courts tend to be strict in application of the UCC consignment provisions in such cases. *See In re* Pearson Indus., Inc., 142 B.R. 831 (Bankr. C.D. Ill. 1992); *In re* High-Line Aviation, Inc., 149 B.R. 730 (Bankr. N.D. Ga. 1992).

[49] *See supra* notes 38-40 and accompanying text.

[50] *See* GBS Meat Indus. Pty. Ltd. v. Kress-Dobkin Co., 474 F. Supp. 1357, 1363 (W.D. Pa. 1979).

[51] Artists, with one possible exception, are merchants within the Code. A "merchant" defined in § 2-104(1) as "a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices of goods involved in the transaction." U.C.C. § 2-104(1) (1990). When an artist consigns, or even sells, his first work, he may not think of himself as a merchant and the Code may not deem him one who "deals in goods of the kind." But when he sells a second artwork, then he deals in goods of the kind, and is tied to the merchant standard. Where such a definition would be apt for an Andy Warhol, for the majority of artists, who do not control the resources of such a figure, this would not be an appropriate classification. This leads to the further problem, central to the failure of the revisions: artists are definable as merchants, and therefore an exception for consumers written into the Code will not reach the artist. Along these lines, a consumer goods exception will also exclude art transactions where the artwork is not used within the limited definition of consumer goods, defined in § 9-109 of the UCC as those goods "used or bought primarily for personal, family, or household purposes." U.C.C. § 9-109 (1990).

[52] *See* LERNER & BRESLER, *supra* note 38, at 35. *But cf.* FRANKLIN FELDMAN ET AL., ART LAW: RIGHTS AND LIABILITIES OF CREATORS AND COLLECTORS § 3.2.1, at 361 (1986) ("Lurking behind the presumed necessity of adopting these laws [artist-art dealer consignment statutes] was the vision of a villainous dealer with infernal intent, ever ready to pounce on the deprived and defenseless artist.").

[53] Alaska adds a subsection to § 2-326 which reads:

> Whenever an artist delivers or causes to be delivered a work of fine art of his own creation to an art dealer for the purpose of sale, or exhibition and sale to the public on a commission or fee or other basis of compensation, the work of fine art is not subject to the claims of the art dealer's creditors. For the purposes of this subsection

for artists from the loss of their work by reason of the application of Section 2-326,[54] clarifying the agency relationship between artist and consignor and creating a safe harbor from the Code provisions that would otherwise regulate the transaction.[55]

The most effective artist-protection statutes automatically protect the artist against the claims of a consignee's creditors.[56] However, some state statutes provide less extensive protection for artists, employing formalities that closely track UCC requirements.[57] In Florida, for example, before the artist can claim the right to take his property or its value before a secured creditor, he still must follow statutory requirements that put the world on notice that the goods are subject to a contract of consignment.[58] These formalities seem contrary to the central purpose of these statutes, 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.

Many of the statutes require a written consignment agreement between the artist and dealer before the artist will be protected.[59] Although some statutes provide criminal sanctions against the

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(1) "art dealer" means a person other than a public auctioneer engaged in the business of selling works of fine art;

(2) "artist" means the creator of a work of fine art;

(3) "fine art" includes a painting, sculpture, drawing, photograph, or work of graphic art.

ALASKA STAT. § 45.02.326(e) (1993).

Arkansas adds a subsection (5), which states that "[t]he provisions of this Section [2-326] shall not apply to the placement of works of fine art on consignment." ARK. CODE ANN. § 4-2-326(5) (Michie 1991).

54 *See* LERNER & BRESLER, *supra* note 38, at 26.

55 The New York statute specifically articulates the fiduciary relationship between artists and dealers. The statute presumes that whenever a work has been delivered to a dealer, it will be considered a consignment and not an outright sale for which compensation is paid. As consignee, the dealer must act as the artist's agent, treat the work as trust property, and hold sale proceeds as trust funds for the artist. N.Y. ARTS & CULT. AFF. LAW § 12.01(a) (McKinney Supp. 1991). Several states have extended protection to anyone who consigns art. *See* CONN. GEN. STAT. ANN. §§ 42-116k to -116m (West 1992); FLA. ANN. STAT. §§ 686.501-.506 (West 1990); MICH. COMP. LAWS ANN. §§ 442.311-.315 (West 1989); 73 PA. CONS. STAT. ANN. §§ 2121-2130 (1993).

56 *See* N.Y. ART & CULT. AFF. LAW §§ 12.01, 12.03 (McKinney Supp. 1991) (which does not require the artist to take any measures of protection against the claims of a consignee's creditors once he has entered into a consignment with the art dealer); CAL. CIV. CODE §§ 1738.5-.9 (West 1985).

57 *See* CONN. GEN. STAT. ANN. § 42-116m (West Supp. 1992); FLA. ANN. STAT. § 686.502(2) (West 1990).

58 The Florida statute requires that the artist "affix[ ] a sign or a tag to the work" or that the consignee "post a clear and conspicuous sign in the consignee's place of business giving notice that some works of art are being sold subject to a contract of consignment." FLA. ANN. STAT. § 686.502(2) (West 1990).

59 *See* FLA. ANN. STAT. §§ 686.503-.504 (West 1990); OR. REV. STAT. §§ 359.220 (Butterworth 1987).

The Oregon statute reads in relevant part:

An art dealer may accept a work of [art] . . . on consignment from the artist who

dealer for failure to create the written agreement or for diversion of the proceeds of a sale,[60] these sanctions have no bearing on the claims of creditors, and thus do not help the artist. When the dealer fails to comply, creditors are left without notice and thus have a strong argument for retaining the artwork, since these statutes still condition protection of the artist on a creditor's receiving notice of the art consignment.

In some jurisdictions, depending on the wording of the statute, the creditor may also argue that the statute fails to specifically repeal the relevant Code provisions, and that therefore Section 1-104 (which provides that the Code provisions prevail over subsequent conflicting legislation) requires that the Code provisions prevail.[61] The case law supports the proposition that the Code will trump subsequent legislation unless that subsequent legislation expressly repeals the Code, if not the specific Code sections.[62] If the legislation does not contain such a repealer, the courts will attempt to harmonize the subsequent legislation with the UCC; and should the conflict between the two be irreconcilable, courts will find that the Code governs.[63]

Many art consignment statutes fail to provide any language

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created the work of fine art only if prior to or at the time of acceptance the art dealer enters into a written contract with the artist establishing:
(a) The retail value of the work of fine art;
(b) The time within which the proceeds of the sale are to be paid to the artist, if the work of fine art is sold;
(c) The minimum price for the sale of the work of fine art; and
(d) The fee, commission or other compensation basis of the art dealer.

Id. § 359.220(1)(a)-(d).

60 The Oregon statute makes the dealer liable to the artist for the failure to create the written agreement and makes the diverting of proceeds a Class C felony. OR. REV. STAT. § 359.240 (Butterworth 1987).

61 Section 1-104 reads: "This Act being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided." U.C.C. § 1-104 (1990). The Official Comment to § 1-104, which states that the Code 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[,]" makes clear that the Code is not meant to be susceptible to conflicting subsequent legislation. U.C.C. § 1-104 cmt. (1990) (citing Pacific Wool Growers v. Draper & Co., 73 P.2d 1391 (Or. 1937)).

As of publication of this Note, no art consignment statute has been challenged as violative of the § 1-104 repealer.

62 A number of cases discuss the specificity of the statutory language required for a statute to be deemed an explicit repeal of the UCC. *E.g.*, Jackson v. H. Frank Olds, 382 N.E.2d 550 (Ill. App. Ct. 1978); *In re* Alper-Richman Furs, Ltd., 147 B.R. 140 (Bankr. N.D. Ill. 1992); *In re* State Street Auto Sales, Inc., 81 B.R. 215 (Bankr. D. Mass. 1988); Colt v. Fradkin, 281 N.E.2d 213 (Mass. 1972). *See also* Opinion of Attorney General of Michigan Number 6535, August 7, 1988, 7 U.C.C. Rep. Serv. (Callaghan) 208 (1988) (suggesting that when a statute contains the boilerplate "notwithstanding any other law" provision, the statute should not be read to expressly repeal a UCC provision and, hence, the court should attempt to harmonize the statutes, or declare the UCC superior).

63 *See In re* White Farm Equipment Co., 63 B.R. 800 (Bankr. N.D. Ill. 1986).

that expressly repeals either the Code or Section 2-326. While New York's statute does contain language that explicitly repeals Section 2-326 and related Code provisions,[64] many other state statutes simply provide boilerplate "all acts and laws to the contrary notwithstanding" repealer language.[65] The failure of most art consignment statutes to expressly repeal Section 2-326 of the Code may render these statutes ineffective in protecting the art consignor from a dealer's creditors.[66]

III. Common Law and Code Treatment of Consignment: A Comparison

A. *Common Law Treatment of Consignment: Good Faith Considerations*

The common law of consignment found roots in notions of good faith and a budding doctrine of ostensible ownership.[67]

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64 "No such trust property . . . shall be or become subject or subordinate to any claims, liens, or security interests . . . of the consignee's creditors, anything in § 2-326 of the uniform commercial code or any other provision of the uniform commercial code to the contrary notwithstanding." N.Y. Arts & Cult. Aff. Law § 11.03(1)(c) (McKinney 1994). *See also* Memorandum of New York State Senator Roy Goodman, N.Y. 1975 Legis. Ann. 96 (1979).

65 For example, the Oregon statute merely states that "notwithstanding any custom, practice, or usage of the trade to the contrary" consignment of art is not subject to the claims of creditors. Or. Rev. Stat. § 352.409 (1985).

66 Two recent cases, Neufeld v. Freeman, 794 F.2d 149 (Bankr. 4th Cir. 1986), and Shuttie v. Festa Restaurant, Inc., 566 So. 2d 554 (Fla. Dist. Ct. App. 1990), illustrate the inadequacy of both the UCC and the non-uniform art consignment legislation.

In *Neufeld*, an artist, who consigned works to a dealer who subsequently went bankrupt, found himself confronted by the dealer's creditors in bankruptcy. To protect his interest in his works, the artist had no recourse to an art consignment statute since Virginia doesn't have one and, apparently, he did not comply with the requirements of UCC § 2-326. Although the court did not discuss § 2-326, it simply referred to the artist as an unsecured creditor. *Neufeld*, 794 F.2d at 150. The artist was treated no differently than other unsecured creditors of the bankrupt dealer. Thus, the artist could not reclaim the proceeds of the consigned work, but instead found himself mired in bankruptcy litigation.

In *Shuttie*, an art dealer conveniently disappeared after putting up the artist's works as security for loans amounting to roughly $60,000. *Shuttie*, 566 So. 2d at 556. The artist, Shuttie, failed to comply with both the provisions of § 2-326 and Florida's art consignment law, which requires an art consignor to affix a sign or tag that explains that the work is subject to consignment to the work of art. *Id.* at 556-57. Since the artist did not comply with the later requirements, the court held that the creditor should prevail under the "long established principle of law that as between two innocent parties, the one that created the situation causing the loss, will not be held to have a superior position. . . . [T]he UCC has not altered this common law principle." *Id.* at 558. See *also* Heise, *supra* note 36, at 484, for a further discussion of *Shuttie* and the Florida art consignment statute.

67 *See infra* note 155. The Article 2 Study Group, highlighting some of the policies underlying the actual drafting of the Code, noted that "Grant Gilmore argued that the purpose of general commercial legislation should be to 'clarify the law about business transactions rather than change the habits of the business community.'" Permanent Editorial Board of the Uniform Commercial Code, Article 2 Study Group Preliminary Report (March 1, 1990) 6-7 (1990) (citing Grant Gilmore, *On The Difficulties of Codifying Commercial Law*, 57 Yale L.J., 1341, 1341-42 (1948)).

Common law courts, unconstrained by the language of the Code, placed more emphasis on the rights of the owner of goods than the UCC allows.[68] This made for complex, and sometimes confusing case law, which the drafters of the UCC may well have thought they were ameliorating by a statute which, on the whole, injured owners' interests that were recognized by the common law courts. However, a survey of consignment decisions under the Code reveals parallels between the treatment of consignors' interests by common law courts and Code courts, and also reveals that Code courts continue to reach results that common law courts would consider appropriate—despite the facial Code preference for creditors.[69]

Under common law, the question of whether the owner or creditor would have possessory rights in the goods depended not on giving the creditor notice of the owner's interest, but on whether the owner and the transferee intended that title pass between them. The concept of title served as a shorthand for the idea that when the court found that an arrangement looked like a sale, or a security agreement, merely claiming that title did not pass would not defeat a creditor's claims.[70] If a court found that the parties intended title to pass, the court would likely find that the transaction created a secret lien and the creditor would likely prevail.[71] On the other hand, if a court found that the parties did not intend a sale between them or that the goods were not to act as security for the payment of their price, that court would likely find that the parties did not intend to pass title, and would find the transaction to be a consignment.[72] As the court in the late nineteenth-century case of *Peek v. Heim* noted, "[w]hen goods are consigned to a factor for sale, they remain the property of the consignor, and are not subject to the debts of the factor, and no ingenious contract is required to protect them from his creditors."[73]

In 1909, the Supreme Court, in *Ludvigh v. American Woolen*

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68 *See* Ludvigh v. American Woolen, 231 U.S. 522 (1909). *See also* Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1057-58 (1954) (noting the historical conflict between owners, buyers, and creditors of goods and both third-party buyers of those goods and creditors that extend credit against the goods, and courts' reluctance to sacrifice owners' rights).

69 *See infra* part IV.

70 This basic principle is carried over and extended in the UCC. *See* U.C.C. §§ 1-201(37), 2-326, 2-401(2).

71 Peek v. Heim, 17 A. 984, 985 (Pa. 1889).

72 *Id.*

73 *Id.*

Co.,[74] held for the owner of goods as against the consignee's creditors. The Court put forth the rule that in a true consignment, the title to the goods remains in the consignor; hence, the consignee has no interest to give his creditors.[75] The Court found that since the consignee is not obligated to buy the goods, but may return them in lieu of the price, the consignor's interest is not a mere security interest but an interest of absolute ownership.[76] Further, rejecting the creditor's notice arguments, the Court noted that

> [i]t is urged that the goods were not kept separately, but it appears that the tags of the Woolen Company were left upon the goods and it is not shown that any creditor relied upon mismarking or misbranding. And memoranda are in evidence showing the names of certain salesmen thereon, but on these same bills it is stated that the goods were furnished under the agreement already referred to.[77]

Despite the Supreme Court's pronouncement, some lower courts continued to find for creditors while paying lip service to *Ludvigh*. These courts first reasoned that since no title passes from owner to transferee in the true consignment, the relationship between the two parties must be considered one of agency.[78] The agency relationship allows the consignee only the limited power to sell. However, when the transferee is permitted by the owner to act as something more than an agent, such as when the transferee sets a price for the goods, contracts to keep any excess profit over an invoice price, or neglects to segregate either the goods or the proceeds of the sale, the courts would find that the agent had exceeded the scope of an agent's authority. Thus, the transaction must have been something other than a mere consignment: it must

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74 Ludvigh v. American Woolen Co., 231 U.S. 522 (1909). In *Ludvigh*, the consignor (the American Woolen Company) consigned goods to one Horowitz. Horowitz later embezzled the funds of his company and, after a mysterious fire on the premises, disappeared. *Id.* at 526. American Woolen then reclaimed its goods prior to bankruptcy and the administrator in bankruptcy proceedings sought to have the goods returned for the benefit of Horowitz's creditors. *Id.* at 522-23.

75 *Id.* at 528.

76 *Id.* The Court also noted that "an agency to sell and return proceeds or the specific goods stands upon the same footing as a bailment where the identical article is to be returned in the same or altered form and title to the property is not changed." *Ludvigh*, 231 U.S. at 528 (citing Sturm v. Boker, 150 U.S. 312, 330 (1893)).

77 *Id.* at 529. Interestingly, American Woolen did know enough to demand that Horowitz incorporate (Woolen then took the majority share in Horowitz's operation and had an accountant appointed to oversee Horowitz's finances) and hence should have known to give notice to creditors. *Id.* at 525-26. The Court, however, did not consider this a factor in their decision.

78 *See* Steven Hawkland, *Consignment Selling Under the Uniform Commercial Code*, 67 COM. L.J. 146 (1962).

have been a disguised security interest.[79] Alternatively, a court might simply find the transaction to be a sale, conditional sale, or chattel mortgage from the start, negating any claim of agency.[80]

However, owners do not always have equity on their side. *Joseph v. Winakur*[81] is a prime example of how a court, reacting to a lack of good faith on the part of the owner of goods, evaded the *Ludvigh* rule.[82] Here, an owner of automobiles, Winakur, and a car dealer had a business arrangement that extended for a few years prior to the dealer's bankruptcy. The arrangement called for Winakur to loan money to the dealer, who in turn used that money to buy cars. The dealer then "sold" the cars to Winakur, and Winakur "consigned" them back to the dealer.[83] Essentially, Winakur sought to bind the dealer to the payment of the price, while he did not take any measure to notify potential third-party creditors of his interest. The idea was to leave Winakur free of claims while the dealer could use the cars as collateral on loans from unsuspecting creditors.

The court in *Winakur* declined to permit the owner of the goods to manipulate the law to obtain the benefit of the consignment rule of *Ludvigh.* Instead, the court found that whatever the parties chose to call their transaction, the substance was one of "a mortgage with a power of sale on the part of the mortgagor, and with the right on the part of the mortgagee to take possession, if sale was not made within a certain period of time."[84] And, since this unfiled mortgage was in fact a form of security interest, the court did not think Winakur should be able to "give his debtor a false credit by withholding his mortgage from record, and then as-

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[79] *See* Reliance Shoe Co. v. Manly, 25 F.2d 381 (4th Cir. 1928) ("consignment" of shoes to consignee, which gave consignee no right to return the merchandise, unless goods failed to conform with sample, and required it either to pay invoice price in full or to make up difference if the goods were returned and sold for lesser price, and provided that no title vested in consignee was not a mere contract for consignment); Best Made Clothing Co. v. O'Brien, 262 N.Y.S. 56 (N.Y. Civ. Ct. 1932) (sale on "consignment" was part of scheme between seller and buyer, who were in effect one corporation, to defraud creditors).

In the oft-quoted *Liebowitz v. Voiello,* the Court of Appeals for the Second Circuit noted that:

> [i]t is not readily apparent why any consignment arrangement is not a secret lien against creditors of a shaky consignee, as harmful as an unfiled chattel mortgage or conditional sale. But that matter has been settled for us, for the Supreme Court has held that a consignment contract . . . is valid against a trustee in bankruptcy.

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

[80] *In re* Wayside Furniture Co., 67 F.2d 201 (7th Cir. 1934).

[81] Joseph v. Winakur, 30 F.2d 510 (4th Cir. 1929).

[82] For the *Ludvigh* rule see *supra* note 74 and accompanying text.

[83] *Id.* at 511.

[84] *Id.* at 512.

sert it on the eve of bankruptcy and take the apparent assets of the bankrupt into his possession to the exclusion of other creditors."[85]

All in all, such varied judicial interpretation of consignment issues could not provide for the efficient management of interests of consignors and creditors. As Professor William Hawkland, a respected Code scholar, noted, the rule in *Ludvigh* did "nothing to protect innocent creditors of the consignee who may be misled by the fact that he [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."[86] Professor Hawkland also found that the holdings undermining the *Ludvigh* rule were just as undesirable. "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."[87]

Writing in the early 1960's, Professor Hawkland celebrated what was then the relatively new UCC, particularly Section 2-326, arguing that the provisions of that section provided the balance necessary to afford both creditors and consignors protection—assuming both parties followed Code provisions.[88] Professor Hawkland believed that the new Code provisions would allow consignors to signal their interests (by way of either the sign provision or filing) and that the "generally known" provision would protect consignors from creditors with knowledge of the consignment.[89] He pointed out that "[i]ndeed, the consignor's creditors may know all along that their debtor is in the business of handling goods belonging to others, and thus be given an unearned windfall by the courts' solicitude for them."[90] However, the greater uniformity of decision reached through the state-by-state adoption of the Code was accomplished by way of a statute which attempted to eliminate consideration of the good faith of the owner from the purview of the courts.

B. *Code Treatment of Consignment*

Although the Code recognizes consignment transactions, early drafts of the Code reflect the drafters' ambivalence toward consign-

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85 *Id.* at 515.
86 Hawkland, *supra* note 78, at 146.
87 *Id.* at 147.
88 *Id.* at 147-48.
89 *Id.* at 147.
90 *Id.*

ment and, perhaps, an intent to provide only a narrow exception for the transaction. Notably, the 1949 Code definition of "security interest" completely submerged the consignment, flatly stating that a consignment was a security interest to be governed by Article 9.[91] Not until the 1952 draft was the definition of "security interest" amended to provide that consignments not intended as security would be governed by Article 2.[92] As further evidence of drafter ambivalence to the consignment, early drafts of the Code referred to consignments as deliveries to "buyers" for "resale."[93] In consignment, the consignee is not a buyer of goods from the consignor for resale but is the seller of the goods in the first instance.[94]

The final version of the Official Text (1962) gave grudging recognition to true consignments.[95] Under what is now the current law, before the owner may attempt to make use of the meager protections of Section 2-326(3),[96] he must first convince a court that the transaction in question is a consignment, or at least not a security transaction. This can be a tricky affair because the Code does not provide a definition of consignment.[97] Instead, Section 1-201(37) states that "[u]nless 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)."[98] Hence, a court must determine whether a transaction, even if called a consignment, is intended as security.[99] If the "consignment" is so characterized, Article 9 provisions govern.[100] Otherwise, Article 2, Section 2-326, applies.[101]

To work through the Code consignment provisions, consider a hypothetical transaction in which Al, the owner of a Rembrandt, contracts with Bill, who owns Bill's New and Used Art Shop, to sell

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91 *See* Duesenberg, *Consignment Distribution*, *supra* note 22, at 22.

92 *Id.* at 230-31.

93 *Id.*

94 *Id.* at 231.

For additional discussion of drafter ambivalence, see Peter Winship, *The "True" Consignment Under the Uniform Commercial Code, and Related Peccadilloes*, 29 SW. L.J. 825, 825 n.1 (1975) (citing *Hearings Before Enlarged Editorial Board, January 27-29, 1951*, 6 BUS. LAW. 164, 193 (1951)).

95 U.C.C. § 2-326. *See* William D. Warren, *Cutting off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 472 (1963) (arguing that the focus solely on the overt behavior of the parties created a nearly ironclad, pro-creditor rule).

96 *See infra* note 116 and accompanying text.

97 *See* Winship, *supra* note 94, at 825 n.1.

98 U.C.C. § 1-201(37).

99 *See supra* notes 31-34 and accompanying text for treatment of this question by the courts.

100 *In re* Ateco Equipment, Inc., 17 B.R. 230, 230 (Bankr. W.D. Pa. 1982).

101 Section 2-102 states that Article 2 "does not apply to any transaction . . . intended to operate only as a security transaction." U.C.C. § 2-102 (1990). *See also In re* Ateco Equipment, Inc., 17 B.R. 230, 230 (Bankr. W.D. Pa. 1982).

Al's Rembrandt.[102] In Case One, the contract calls for Bill either to return the Rembrandt or to pay Al $1000 by a certain date. In Case Two, there is no set price, but Bill must return the Rembrandt if it remains unsold.[103] Al and Bill contract in both cases that Al retains title in the Rembrandt and has the right to reclaim it at any time. After Al delivers the Rembrandt to Bill's New and Used Art Shop, Bill finds a creditor, Charlie, who is willing to extend credit to Bill in exchange for a security interest in Bill's inventory, which includes the Rembrandt.[104] Bill then goes bankrupt; both Al and Charlie claim the painting.

A court is likely to interpret each of the two transactions—Case One, in which Al is guaranteed either *the* price or the return of the goods, and Case Two, in which the owner guaranteed *a* price or the return of the goods—differently.[105] In Case One, the transferor has no interest in the goods except as they have a dollar value. Hence, the return of the goods is merely collateral put up by the transferee to guarantee a value equal to the price. Such an arrangement is akin to a security arrangement, and should be governed by Article 9. Case Two resembles a typical artist-dealer consignment. The transferor is not in a position to set a price for his goods, and is willing to forego a promise of payment of a certain dollar amount, a promise that would likely not be forthcoming in any event. Hence, Case Two should be considered a consignment governed by Article 2.

When a court finds that the transaction in Case Two is not for security, and thus falls under Article 2, the first step in applying Section 2-326 is to characterize the transaction as one of four types, of which only two are "true" consignments.[106] Subsection (1) of Section 2-326 concerns the first two types, which are not consign-

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102 This hypothetical is based on the case of *Peek v. Heim.* 17 A. 984 (Pa. 1889).

103 The facts of Case Two also fit within consignment as defined in *Consolidated Accessories Corp. v. Franchise Tax Board of the State of California,* 208 Cal. Rptr. 74, 77 (Cal. Dist. Ct. App. 1984). *See supra* note 31.

104 The UCC defines a security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation." U.C.C. § 1-201(37).

105 For example, in *O'Brien v. Chandler,* 765 P.2d 1165 (N.M. 1988), the court found that where cattle is delivered by a cattle dealer to a cattle broker with an invoice specifying the price to be paid, the transaction is considered a sale and creditors relying on the receipts for the cattle and the dealer's representations that the cattle are paid for is a good faith purchaser under § 2-403 and prevails over the cattle dealer on a claim to the goods.

106 Where a court applies § 2-326 to the hypothetical Al of either Case One or Case Two, Al will quickly discover that the provisions of § 2-326 are weighted against the consignor. If Al fails to file, per Article 9, Charlie, claiming the goods as a secured creditor, will prevail. As Official Comment (2) to § 2-326 states: "subsection (3) resolves all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer." U.C.C. § 2-326 cmt. 2 (1990).

ments: the "sale on approval" and the "sale or return."[107] Subsections (2) and (3) address the third and fourth types, the consignment and the consignment outside the reach of Code.[108]

The sale on approval, essentially a device that recognizes a buyer's desire to "test" a product before making a final purchase, has generated little litigation.[109] The sale or return is defined in subsection (1) as a transaction in which "the delivered goods may be returned by the buyer even though they conform to the contract."[110] Subsection (2) states that, with the exceptions noted in subsection (3), "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."[111]

Subsection (3) defines the third type of transaction, the consignment—where the first "sale" takes place between the transferee and a third party.[112] Here, barring an exception, the goods are deemed to be on sale or return and thus subject to the claims of the buyer's creditors while in the buyer's possession.[113]

If a court finds that a transaction is neither a sale on approval nor a sale or return, and the provisions of first sentence of subsection (3) are not met, the transaction is of the fourth type. It is deemed outside the Code provision and subject to common law. Courts have reached this result in a few cases, occasionally finding a consignment not for "sale,"[114] or finding that a consignee did not

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107 U.C.C. § 2-326(1).

108 U.C.C. 2-326(2), (3).

109 Professor Winship notes that § 2-326 codifies prior law in that creditors are given no rights to goods in the possession of the buyer until approval. Winship, *supra* note 94, at 835. "In practice this may not raise many problems because the trial period will be relatively short and the process of testing may itself call attention to the buyer's limited rights." *Id.* But, creditors may prevail over the owner of goods transferred on sale or return. *Id.* (citing Valley Bank & Trust Co. v. Gerber, 526 P.2d 1121 (Utah 1974) (passing of two months after delivery without exercising option to return deemed acceptance and creditor's claim to goods prevails)).

110 U.C.C. § 2-326(1). *See also* Winship, *supra* note 94, at 836-38.

111 U.C.C. § 2-326(2).

112 Even though not specifically called "consignment," the use of the term consignment in the section caption and lack of specification within the text of the provision suggests that this is the consignment. The Article 2 Draft eliminates this problem by separating sale on approval and sale or return goods from consignment in two separate sections. *See* ARTICLE 2 DRAFT, *supra* note 11, at 45-47.

113 The subsection states that "[w]here 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." U.C.C. § 2-326(3).

114 *See* Manger v. Davis, 619 P.2d 687 (Utah 1980); *see also* Walter E. Heller & Co. S.E. v. Riviana Foods, Inc., 648 F.2d 1059 (5th Cir. 1981) (delivery of goods to warehouseman for delivery to buyers from owner deemed not a "sale" within § 2-326).

maintain a place of business in which he dealt in goods of the kind, a requirement for characterizing the transaction as a sale or return and, hence, a Section 2-326 transaction.[115]

Subsection 2-326(3) does allow the consignor some protection from the consignee's creditors by way of certain exceptions, satisfaction of any one of which would indicate that creditors have not been misled by possession of the goods by the consignee.[116] An owner may prevail over the buyer's creditors if: (a) he can evidence his interest by a "sign";[117] (b) he establishes, during the course of a subsequent litigation, that "the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others";[118] or (c) he "complies with the filing provisions of the Article on Secured Transactions, Article 9."[119]

Exception (a), the sign-posting exception, offers little protection since only two states, North Carolina and Mississippi, actually have sign laws on the books.[120] For this reason, there are few cases in which a consignor has successfully employed exception (a).[121] The dearth of sign laws means that a consignor's declaration of his continued ownership right in the goods by means of a label affixed to the goods until sale has no legal effect in most jurisdictions.[122]

Exception (b), which requires the consignor to prove that creditors know that the transferee is "generally known by his creditors to be substantially engaged in selling the goods of others," may

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115 *See* Allsop v. Ernst, 20 B.R. 627 (Bankr. S.D. Ohio 1982) Bischoff v. Thomasson, 400 So. 2d. 359 (Ala. 1981); Manger, 619 P.2d 687; *In re* Mincow Bag, 288 N.Y.S.2d 364 (N.Y. App. Div. 1968), *aff'd mem.*, 248 N.E.2d 26 (N.Y. 1969).

116 Section 2-326 places the burden of proof of compliance with such exceptions upon the consignor. *In re* State Street Auto Sales, Inc., 81 B.R. 215 (Bankr. D. Mass. 1988).

117 U.C.C. § 2-326(a). Simply put, this exception provides that if the consignor evidences his ownership to creditors by means of a sign or label affixed to the goods, he retains a superior claim to the goods. However, the UCC does not itself authorize such measures: it only recognizes *applicable* state sign law. Hence, the consignor must look to other state law to see if such measures are authorized.

118 U.C.C. § 2-326(3)(b).

119 U.C.C. § 2-326(3)(c).

Other remedies available to a consignor may include § 2-507(2), under which a cash seller of goods is entitled to payment on delivery to the buyer, and § 2-702, under which a credit seller has a limited reclamation right against an insolvent debtor. U.C.C. §§ 2-507, 2-703 (1990).

120 N.C. COMM. & BUS. CODE §§ 66-72 (1992); MISS. CODE ANN. § 15-3-7 (West Supp. 1989).

121 *See In re* Sullivan, 103 B.R. 792 (Bankr. N.D. Miss. 1989); BFC Chemicals, Inc. v. Smith-Douglass, Inc., 46 B.R. 1009 (Bankr. E.D. N.C. 1985).

122 *See* THOMAS M. QUINN, QUINN'S UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST § 2-326[B][12] (1990 Cum. Supp. No. 1) (citing United Agri-Products Fin. Servs., Inc. v. O's Gold Seed Co., 733 P.2d 252 (Wyo. 1987)). *But see* Medalist Forming Systems, Inc. v. Malvern Nat. Bank, 832 S.W.2d 228 (Ark. 1992) (consignor could have protected himself against consignee's creditors by posting sign). In this case, even the court misunderstood the Code provisions, since the Code does not provide a sign law but merely enables states to supply their own and Arkansas has no sign law.

also be of little help to the consignor, since proving such knowledge can be difficult. For example, one court has held that "generally known" means that "most" creditors must know, and where the numbers indicate merely that "some" knew, the requirements of the exception have not been met.[123] Another court found that a showing that twenty percent of bankrupt's creditors knew of bankrupt's involvement in consignment fell short of meeting the requirements.[124]

Exception (c) directs the consignor to file a security interest in accordance with the provisions of Section 9-114(1)(a)-(1)(d).[125] Under Section 9-114(1), the owner must file the security agreement before the consignee receives possession of the goods, and must give written notification of such consignment to secured creditors of the consignee who "ha[ve] filed a financing statement covering the same types of goods before the date of the filing made by the consignor."[126] The notification must be received by the secured party within five years before the consignee receives possession of the goods, must state that the consignor intends to deliver goods on consignment, and must describe the goods.[127] Should the consignor fail to perform these tasks, under Section 9-114(2) his interest is subordinated to "a person who would have a perfected security interest in the goods if they were the property of the debtor."[128] The business-savvy owner of goods entering into a consignment transaction who seeks the best protection from claims to

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123 Sullivan, 103 B.R. 792.

124 *In re* Wicaco Mach. Co., Inc., 37 B.R. 463 (Bankr. E.D. Pa. 1984). *See also In re* BRI Corp., 88 B.R. 71 (Bankr. E.D. Pa. 1988); 2 HAWKLAND, *supra* note 1, § 2-326:04, at 787-88.

125 U.C.C. § 2-326(3)(c).

126 U.C.C. § 9-114(1)(b) (1990).

127 U.C.C. § 9-114(c)-(d) (1990).

128 U.C.C. § 9-114(2).

Even if the consignor is aware that filing is a better protection, the filing itself is subject to pitfalls. *See* Milhender Distrib. Co. v. Fairway Wholesale, Inc. (*In re* Fairway Wholesale, Inc.), 21 U.C.C. Rep. Serv. 1429 (D. Conn. 1977) (where consignor's goods constituted less than all of consignee's inventory, a financing statement, which describes the consigned goods as "all goods, wares, and merchandise" that the consignor sees fit to deliver, fails to reasonably identify the goods as per § 9-110).

A possible glitch in the Article 2 Drafting Committee's December Draft, which defines consignment as a non-sale between the owner and the consignee, will exclude the consignor from the self-help remedy of § 2-702. According to the tentative, and incomplete, draft definitions, under § 1-201(33), a "'sale' means the passing of title from a seller to a buyer for a price" and, under § 1-201(36), a "'seller' means a person who sells or contracts to sell goods." This definition of seller does not encompass the consignor, who is not selling his goods to the person who deals in goods of the kind, since the draft declares that the goods are delivered to the consignee for the purpose of sale (to third parties). Since the § 2-327 language implies that no sale has taken place between consignor and consignee, and hence the consignor will not fit the definition of seller and will not be able to take advantage of Article 2 seller's remedies. *See* ARTICLE 2 DRAFT, *supra* note 11, §§ 1-201(33), 1-201(36), 2-327. *See also* U.C.C. § 2-702.

his goods that might arise from a consignee's creditors would choose exception (c). And here again is the problem for artists and other individual consignors. Although merchants within the Code, they may not be aware of the requirements of the Code.

The effect of the Code consignment provisions would be the same for (1) an owner who delivered his goods to the dealer with the expectation of either the receipt of a percentage of the sale price or the return the goods, if they remain unsold, (2) the owner who delivers goods to a dealer expecting a set price, and (3) unsecured creditors such as Winakur. Although in Winakur's case, the outcome seems correct—Winakur obviously carried on a credit relationship with the car dealer, and attempted to recharacterize his transaction as a consignment to gain priority over the consignee's creditors—there is a qualitative difference in the character of the actors involved in the respective transactions which should, but does not, lead to a different result.[129] Simply put, the first owner, who had no intention of creating a security arrangement and no reason to know of an obligation to secure his interest, is treated in the same manner as Winakur. If the principal object of a draftsman is to be "accurate and not to be original,"[130] the replacement of rules which allowed scrutiny of both the original transferee's intent, as well as the scrutiny of the secured creditor's good faith, the UCC may have fallen short of such a goal, proving more original than accurate.

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129 This situation is similar to the consignor's in the case of *Allgeier v. Campesi.* In *Allgeier,* an individual owner of an automobile delivered it to an automobile dealer for the purpose of having the dealer secure offers for the purchase of the car. Upon approval of an offer by the owner, the dealer could sell the car and receive a set commission (not based on the sale price). *Allgeier v. Campesi,* 159 S.E.2d 458, 459 (Ga. Ct. App. 1968). The court, reaching the equitable result in this case, found the transaction not a "sale or return" and hence not subject to the claims of the dealer's creditors. *Id.* at 459.

130 ARTICLE 2 REPORT, *supra* note 67, at 7 (citing Grant Gilmore, *On the Difficulties of Codifying Commercial Law,* 57 YALE L.J. 1341, 1341-42 (1948)). Expounding on Gilmore's comment, the Study Group notes the friction between accuracy and originality. The Study Group notes the difficulty in discovering, and hence accurately accounting for relevant practices, and that some habits of the business community may need to be changed. *Id.* at 7-8. The Study Group also mused over how much of the infinite variety of commercial behavior the Code could account for before becoming overly complex. The Study Group then left open the question:

> [s]hould, then, a commercial statute be concerned about bad habits that fall between the cracks and, if so, how does one determine what is bad and what remedies are appropriate? The question has particular relevance for disputes where the buyer is a consumer, i.e., an individual who purchases for personal, family or household purposes.

Id. at 8.

Here, the number of cases in which consignors win is alone evidence of behavior that is more than that slipping "between the cracks." It is behavior for which the Code, in order to be more accurate, must make provision.

IV. UNRULY COURTS: EQUITY IN THE INTERPRETATION OF SECTION 2-326

One intuitively senses that Al and Winakur are two different types of actors both making use of the consignment transaction.[131] The former uses the consignment as a bailment, and parts with possession, but not ownership, of the goods. Putting aside all notions of the Code, or any knowledge of the law, one can understand why this type of consignor should be able to assert his claim to the goods. Just as with artists, these individual consignors are frequently unaware of the law governing consignment. In contrast the latter uses the goods to secure a debt. In such cases, the courts find that this type of consignor has only a security interest, rather than ownership rights, in the goods.[132]

Precisely this intuition has led some courts to grant consignors more protection than a faithful reading of the Code would otherwise allow,[133] which suggests that the Code does not fully satisfy the varying fact patterns that one encounters in consignment.[134] For

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131 RONALD ANDERSON, UNIFORM COMMERCIAL CODE: TEXT, CASES, COMMENTARY § 1-102-21, at 39 (3d ed. 1980) ("A court should adhere strictly to the provisions of the Code to achieve stability, consistency, and predictability." Also, "overly liberal interpretation[s]" must be avoided when interpreting the more ambiguous provisions of the Code so as not to create "uncertainty among businessmen and their legal advisors who believe themselves to be entering into transactions on the basis that the Code means what it says." Anderson goes on to counsel that ambiguity in Code language does not license courts to legislate from the bench.).

132 *Winakur*, 30 F.2d 510, 511-12. The *Winakur* court would agree with such a conclusion, having found that "Winakur was not in the automobile business, but in the business of lending." *Id.* at 512 (4th Cir. 1929).

133 Most courts, however, appear to value uniformity in interpretation as more important than the felt justice of any particular case and are thus less inclined to bend the rules of the Code for the benefit of the hapless consignor. *See In re* State Street Auto Sales, 81 B.R. 215 (Bankr. D. Mass. 1988), where the court refused the suggestion to follow the reasoning of *GBS Meat Indus. Pty. Ltd.* and *First Nat'l Bank of Blooming Prairie* to give priority to consignor when the secured creditor has actual knowledge of the consignment arrangement. The court reasoned that twenty percent is not substantial within meaning of § 2-326 and to penalize the Bank on equitable grounds would "punish the Bank for doing what the UCC encourages; prudent protection of its [the Bank's] security interest. There is no evidence of 'sharp' practices or bad faith on the part of the Bank." *Id.* at 220; *In re* Miller, 119 B.R. 660 (W.D. Ark. 1990) (Overruling District Court ruling, court finds that transaction between individual farmers and grain wholesaler not one of bailment, but controlled by § 2-326. When owners failed to comply with exceptions, creditor prevails.).

See also John Dolan, *The UCC's Consignment Rule Needs an Exception for Consumers*, 44 OHIO ST. L.J. 21, 29 (1983) (Many courts construe § 2-326 narrowly, in keeping with Official Comment 2 of that section, which states that "[t]he purpose of the exception [in favor of the creditor that gives notice] is merely to limit the effect of the present subsection itself *. . . to cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation.*") (citing U.C.C. § 2-326 cmt. 2 (1990)) (emphasis added).

134 Professors Leary and Frisch point out that conflicts of decision under given provisions of the Code (as well as the non-uniform amendments, ad hoc statutes impinging on Code rules, and the volume of litigation engendered by a particular Code provision) indicate that the transactions in question are not adequately addressed by the Code. Fairfax Leary, Jr. & David Frisch, *Is Revision Due for Article 2?*, 31 VILL. L. REV. 399, 468 (1986).

example, in *In re Samuels & Co., Inc.*,[135] the Fifth Circuit Court of Appeals found for the secured creditors of the consignee under Section 2-403, holding that "the interest of an unpaid cash seller in goods already delivered to a buyer is subordinate to the interest of a holder of a perfected security interest in those same goods."[136] Such a result, easily reached through a fair application of the Code, was eventually adopted by the court.[137] However, the extended appellate litigation, of *Samuels*, which included two opinions by the Fifth Circuit, suggests that a more fundamental issue—whether the Code adequately accounts for the interests of at least certain types of owners of goods—fueled the debate.[138] What moved the appellate court to find for the owner in the first instance was a sense of equity, a consideration sufficient to compel an at least questionable interpretation of the Code.[139]

In re Zwagerman[140] replays the conflict between owner and creditor in *Samuels*, this time under Section 2-326. Despite the fact that the creditor in *Zwagerman* made out a strong case under Section 2-326(3)(b) that creditors were not generally aware that the dealer dealt in the goods of others, the court cited a number of cases supporting the notion that creditors either were, or should have been, aware that this type of transaction occurs frequently.[141]

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135 *In re* Samuels & Co., Inc., 483 F.2d 557, *reh'g den.*, 485 F.2d 687 (5th Cir. 1973), *rev'd*, Mahon v. Stowers, 416 U.S. 100 (1974), *on remand*, *In re* Samuels, 510 F.2d 139 (5th Cir. 1975), *reh'g en banc* 526 F.2d 1238 (5th Cir. 1976).

136 *In re* Samuels, 526 F.2d at 124.

137 *Id.*

138 The Fifth Circuit opinion notes that the referee in bankruptcy ruled in favor of the sellers and the District Court reversed. *In re* Samuels, 483 F.2d 557, 559 (5th Cir. 1973). The Court of Appeals reversed the District Court. *Id.* at 557. On appeal, the Supreme Court reversed and remanded for a further determination of the facts. Mahon, 416 U.S. 100. Rehearing en banc, the Court of Appeals reversed its original decision, by a three to two vote, and adopted as the opinion of the court the dissent from the first Court of Appeals' opinion. *In re* Samuels, 526 F.2d 1238. Even Congress got in on the act, reversing the decision of *Samuels*. Packers and Stockyards Act, 7 U.S.C. § 192 (1992).

139 The original minority opinion of the Court of Appeals was especially critical of the original majority opinion, noting that the majority

> have not concealed that their orientation in the case before us is to somehow reach a result in favor of the sellers of cattle, assumed by them to be "little fellows," and against a large corporate lender, because it seems the "fair" thing to do. We do not sit as federal chancellors confecting ways to escape the state law of commercial transactions when that law produces a result not to our tastes. Doing what seems fair is heady stuff. But the next seller may be a tremendous corporate conglomerate . . . and the next lender a small town Texas bank. Today's heady draught may give the majority a euphoric feeling, but it can produce tomorrow's hangover.

In re Samuels, 526 F.2d at 1242.

140 *In re* Zwagerman, 115 B.R. 540 (Bankr. W.D. Mich. 1990), *aff'd*, 125 B.R. 486 (W.D. Mich. 1991).

141 *Id.* at 550-52. *See also* Union State Bank of Hazen v. Cook, 63 B.R. 789 (Bankr. N.D. 1986) (where a creditor's casual attitude about the origin of goods fostered a finding for the owner); First Nat'l Bank of Blooming Prairie v. Olsen, 403 N.W.2d 661 (Minn. Ct. App.

Then, after discussing the centuries-old practice of "agisting", the bailment of farm animals, as well as the cattle owner's advanced age and poor legal counsel, the court raised the standard of knowledge required by Section 2-326(3)(b) over and above the "generally known" standard.[142]

Zwagerman is just one example of the courts' willingness to increase the burden on creditors above what is prescribed in the statute, and demonstrates that courts are willing to allow at least certain consignors to prevail by means of this exception. For example, in *General Elec. Credit Corp. v. Strickland*,[143] the court upheld a trial court determination that the consignee, Terry, was known by his creditors to be in the business of selling the goods of others. The court noted that, although Section 2-326 should be strictly construed and that the burden was on the consignor to prove an exception, "Terry had a flashing sign in front of his business advertising that he sold goods for other people. He also advertised on radio that he sold goods for others. Several creditors testified that Terry had sold their goods and that it was commonly known that he sold the goods of others. Finally, GECC knew Terry sold the goods of others."[144]

Yet another example of the use of exception (b) comes in *Brashear v. D Cross B, Inc.*.[145] In that case, a wholesaler entered into a consignment agreement with a financially troubled retailer. When the retailer failed, the creditor bank called in a loan which had been guaranteed by the grandmother of the retail operator. The grandmother paid the loan in exchange for the bank's assignment of all rights in the collateral in the debtor's possession. Noting that the jury below found that the dealer was generally known by his creditors to be a seller of the goods of others, the court up-

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1987) (although § 2-326 applies, owner prevails where creditor has actual knowledge of custom feeding); Rowheder v. Aberdeen Productive Credit Assoc., 765 F.2d 109 (8th Cir. 1985).

142 *In re Zwagerman*, 115 B.R. at 553. The court was careful, however, to cite cases limiting the rights of owners, especially when the transaction between the owner and dealer resembled a sale or return rather than a consignment. *Id.* at 550.

143 General Elec. Credit Corp. v. Strickland Div. of Rebel Lumber Co., 437 So. 2d 1240 (Ala. 1983).

144 *Id.* at 1245. The evidence, as outlined by the appellate court, did not require that the court find the second transaction to be a consignment. A reasonable interpretation of the evidence could easily refute the contention that the creditors "generally" knew of Terry's consignment activities. The court, however, chose to rely on limitations of appellate review to affirm the lower court holding. *Id.* Hence, § 2-326 protected Smith, who recovered his goods. *See also In re* Metro Trade Center, Inc., 22 B.R. 365 (Bankr. E.D. Mich. 1982) (denial of summary judgment when, although unlikely to prevail at trial, consignor presents genuine issue of fact as to whether § 2-326(3)(c) applies).

145 Brashear v. D. Cross B, Inc., 711 S.W.2d 749 (Tex. App. 1986).

held the return of the goods to the wholesaler.[146] Although not a case of misinterpretation, *Brashear* suggests that the generally known exception may in fact provide consignors—at the trial level—a measure of protection against creditors.

Some courts will even set aside the failure of the consignor to comply with the Section 2-326(2) provisions when a creditor had actual notice of the consignment.[147] For example, in *Belmont Int'l. v. American Int'l. Shoe,*[148] a creditor bank foreclosed on a consignee's segregated account which held proceeds of consignment sales. The Oregon Supreme Court found that the exception of Section 2-326(3)(b) protected the consignor's interest in the proceeds of the consignment relationship.[149] The court held that even though the language of the provision refers to creditors, actual knowledge of the consignment relationship by the single creditor in question is sufficient to protect the consignor's interest.[150]

In *GBS Meat Industry Pty. Ltd. v. Kress-Dobkin Co.*,[151] where a foreign meat exporter brought suit against a meat importer and the importer's financing company for conversion, the appellate court sustained a jury finding of the financing company's actual knowledge of the consignment.[152] The court rested its decision on three facts brought out at trial: (1) The creditor was in daily contact with the debtor (consignee); (2) the creditor conducted periodic, full-scale audits of the debtor, which often took several days; and (3) the meat consigned by the foreign exporter never showed up on the accounts payable, although listed as inventory.[153] Then the court held that "where a secured creditor knows that the pro-

146 *Id.* at 750. *See also In re* Key Book Service, 103 B.R. 39 (Bankr. D. Conn. 1989) (Following suggestion that § 1-201 requires liberal construction of UCC provisions to promote underlying principles and policies of the Code and where purpose of § 2-326(3) is to prevent creditors from being misled, where it was "obvious from the evidence" creditor of dealer in used books had full knowledge of consignment before entering into security arrangement with dealer, § 2-326 is not applicable and the creditor's lien does not attach.).

147 This is contrary to a fair reading of § 2-326(3)(b), which states that only when the creditors of the consignee generally know that the consignee substantially deals in the goods of others, will the consignor have superior rights in the goods. Clearly, the statute is speaking not of an individual creditor of the consignee, but of creditors on the whole. Thus, a particular creditor's behavior is not relevant under this section.

148 Belmont Int'l v. American Int'l Shoe, 831 P.2d 15 (Or. 1992).

149 *Id.* at 19.

150 *Id. See also In re* Alper-Richman Furs, Ltd., 147 B.R. 140 (Bankr. N.D. Ill. 1992) (court remands case to determine whether § 2-326 generally known exception applied). Following the suggestion of *GBS Meat Industry Pty. Ltd.* and *In re Gross Manufacturing,* the court noted in dicta that if the bank had actual knowledge of the consignment arrangement between the debtor of the bank and the owner of the goods (furs in the instant case), "this court would hold that the Bank is estopped from asserting its security interest in the goods." *Id.* at 150 n.11.

151 GBS Meat Indus. Pty. Ltd. v. Kress-Dobkin Co., 474 F. Supp. 1357 (W.D. Pa. 1979).

152 *Id.* at 1363.

153 *Id.* at 1359.

ceeds rightfully belong to a consignor, the consignor has priority [over the goods]. Any other construction of [Section] 2-326 would contravene the intent of that section and would sanction intentional conversions of goods or proceeds."[154]

V. AMENDING THE CODE

Some commentators, who view the results of the strict operation of Section 2-326 against consignors as the proper outcome of ostensible ownership doctrine,[155] recommend expanding the filing requirements to cover nearly all situations in which possession and ownership in goods are separated so as to extend greater protection to creditors.[156] Professors Baird and Jackson, perhaps the most vocal proponents of such a view, argue that for creditors who rely on possession in providing credit, "filing systems are valuable sources of information [and are the most cost-effective means for creditors to] secure their loans with an interest in specific property of a debtor."[157] Although they concede that "filing systems may offer few benefits to creditors who do not take a security interest in their debtor's assets" and that "some general creditors may be content to rely on a debtor's unaudited financial statements or the reports of such independent credit agencies as Dun and Bradstreet[,]"[158] they nonetheless note that a secured creditor is able to

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154 *Id.* at 1363. *See also* Newhall v. Haines, 31 U.C.C. Rep. Serv. (Callaghan) 1291, 1297 n.5 (D. Mont. 1981).

155 The Code preference for secured creditors is rooted in the doctrine of good faith purchase, a core concept underlying Code treatment of transactions in goods. Simply put, when a good faith purchaser or a buyer in the ordinary course of business purchases or buys goods, he may rely on the possession of goods by the seller as an indication of ownership ("ostensible ownership") of those goods, and his right to the goods will be protected against the claims of the original owner. U.C.C. §§ 1-201(19), 2-103, 1-201(32), 1-201(33), 2-403. The law protects the good faith purchaser not because of his "praiseworthy character, but to . . . [insure] that commercial transactions may be engaged in without elaborate investigation of property rights and in reliance on the possession of property by one who offers it for sale or to secure a loan." Gilmore, *supra* note 68, at 1057. *See generally* Mooney, *supra* note 27.

The belief that such a doctrine facilitates commerce dates back centuries. *See* William D. Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 469 (1963) (citing William STORY, SALES OF PERSONAL PROPERTY 155-57). And, noting Story's use of the famous Blackstone quote that unless the buyer is "secure of his purchase, . . . all commerce between man and man . . . [will] soon be at an end[,]" Warren, critical of the use of such statements to defend one or another legal result, retorted with a more recent statement: "Owners of goods for commercial and other purposes must frequently intrust others with the possession of them, and the affairs of men could not be conducted unless they could do so with safety." *Id.* (quoting California Jewelry Co. v. Provident Loan Ass'n, 45 P.2d 271, 274 (Cal. Ct. App. 1935) (good faith purchaser from bailee takes subject to true owner's claims)).

156 *See* Douglas G. Baird & Thomas H. Jackson, *An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175 (1983).

157 *Id.* at 183.

158 *Id.*

offer credit, and at a lower rate, not based on "the debtor's honesty and general financial health" but upon precise knowledge of "those claims that others might have upon those assets."[159]

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"[160] and the creditor in question happens to be a large national financing company, some courts attempt to work around the rather strict commands of the Code.[161] 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.[162]

Here is where the difficulty begins. While it is one thing to identify a shortcoming in the Code, it is an entirely different matter to find a workable solution, translating general notions of equity into a workable legal framework. Thus, although the courts have found certain consignors worthy of protection, the question is whether there are any unifying similarities between these cases that can be used to create a workable solution. Can one identify similar types of goods and create an exception based on that? Alternatively, is there a type of consignor, such as a consumer, that can be identified with any specificity? Or should one increase the burden of notice on creditors? The case law supports any one or combination of the above, yet the difficulties are many.[163]

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159 *Id.* at 183-84.

White and Summers advocate a slightly less stringent, yet still restrictive, approach to the classification of consignments. They argue that "the typical business consignment . . . is functionally akin to a security device" because of the parallel between consignment (in the sense that the owner is using his own goods as security for a later payment by the consignee) and the practice of "floor planning," which is "the process whereby a seller or lender finances a retailer by taking a security interest in all of his inventory." WHITE & SUMMERS, *supra* note 101, at 943. They suggest that a consignment that is functionally equivalent to floor planning should be considered as a security interest. *Id.* (citing *In re* Gross Mfg. & Importing Co., 328 F. Supp. 905 (D. N.J. 1971) (discussing concept of floor planning); Founders Inv. Corp. v. Fegett, 23 U.C.C. Rep. Serv. (Callaghan) 903 (Ky. Ct. App. 1978) (example of consignment not intended as security).

160 *See supra* note 139.

161 *See supra* note 133.

162 *See supra* note 140-42, 147-54 and accompanying text.

163 As the Article 9 Study Committee notes:

> [A] consumer-goods exclusion is likely to be not only underinclusive but also overinclusive. Sometimes consumer goods are consigned for sale by individuals

Professor John Dolan, who notes that the rule of Section 2-326 "find[s] support in the idea that the law must discourage commercial entrusters that seek to use the consignment device to achieve a status more favorable than that accorded other parties which have unperfected security interests,"[164] suggests that the Code should accommodate an exception for "consumer" consignors within Section 2-326.[165] Unfortunately, artists are merchants under the UCC,[166] and hence a consumer exception would not apply to them. The only possibility for inclusion in an exception for artists would be to exclude artists by name from the statute, as Alaska and Arkansas have done.[167] Thus, while the inclusion of a consumer

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> who have a good deal of commercial sophistication and as to whom the imposition of a filing requirement would be neither unrealistic nor unduly burdensome (*e.g.*, a sophisticated art collector who consigns art to a gallery). The Committee believes that § 2-326 should be revised to distinguish clearly between those transactions to which it applies and those outside its scope. *The Committee did not attempt to draw a line that distinguishes sophisticated individuals from the vast majority of natural persons who have no knowledge, and no reason to know, of § 2-326.*

ARTICLE 9 REPORT, *supra* note 10, at 187-88, note 7 (emphasis added).

164 Dolan, *supra* note 133, at 42.

165 Dolan, *supra* note 133, at 21-22. *See also* Leary & Frisch, *supra* note 134, at 399; ARTICLE 2 REPORT, *supra* note 67, pt. 3, at 44 ("Consignors who are 'consumers' should be excluded from the public notice requirements of § 2-326(3)." (citing Dolan, *supra* note 133)); ARTICLE 9 REPORT, *supra* note 10, § 25, at 187 ("The Committee, like the Article 2 Study Group, is persuaded by . . . Dolan's arguments.").

In support of his argument, Professor Dolan cites several cases in which the courts have awarded goods to the original owner and which demonstrate that at least certain consignors have swayed the reasoning of the courts. Allgeier v. Campisi, 159 S.E.2d 458 (Ga. Ct. App. 1968) (car owner's delivery of car to dealer so that dealer could sell the car upon the owner's approval of offer and receive a commission held not a "sale or return" under § 2-326(3)); Founders Investment Corp. v. Fegett, 23 U.C.C. Rep. Serv. (Callaghan) 903 (Ky. Ct. App. 1978) (mobile home placed in the possession of dealer by owner for the purpose of having dealer solicit offers for purchase to be relayed to the owner did not constitute "sale or return" within the meaning of § 2-326(3)); Newhall v. Haines, 31 U.C.C. Rep. Serv. (Callaghan) 1291 (D. Mont. 1981) (Section 2-326(3) does transform a consignment of antiques to a "sale or return" where the consignee did not maintain a place of business where he dealt in goods of the kind involved); *In re* Griffen, 1 U.C.C. Rep. Serv. (Callaghan) 492 (Bankr. W.D. Pa. 1960) (used furniture delivered to an individual was subject to prepossession by the owner upon the bankruptcy of the individual); Bischoff v. Thomasson, 400 So. 2d 359 (Ala. 1981) (transaction between purchaser and diamond broker with whom purchaser had placed an order for ring after the broker defaulted on a business loan guaranteed by the purchaser in return for a pledge of the ring constituted a "sale or return" within § 2-326(3)). Dolan, *supra* note 133, at 35-41.

166 *See supra* note 51 and accompanying text.

167 *See supra* note 53. One of Professor Dolan's important insights is that commercial creditors make "credit judgments based on a number of considerations, including the debtor's credit history, its financial statements, and, in some cases, searches for filings in favor of other creditors . . . [And,] [a]lthough some inventory lenders and some working capital lenders are concerned about inventory levels, those lenders are too sophisticated to rely on inspections of the debtor's shelves or showroom and on filings." Dolan, *supra* note 133, at 29. Dolan notes that even though a consumer may extend credit to an enterprise because of "some underlying relationship," that credit is unlikely to include the delivery of an article of merchandise. On the other hand, "[i]f an individual consigns a significant portion of an enterprise's inventory, he cannot claim to be a consumer." *Id.* at 35 n.85.

exception in Section 2-326, as suggested by Professor Dolan, and supported by the Article 2 Study Group, would reduce the need for such an escape hatch for most consignors, it still would not solve the problem for artists, since artists are merchants under the Code.[168]

The Article 2 Study Group has also made a number of suggestions for revision, one of which is the recommendation that a *definition or clarification of consignment be added to the Code.*[169] Another is that the Section 2-326(3)(a) sign law option be deleted.[170] At the very least, the elimination of this section would foreclose further litigation in those states without sign laws. This elimination would also promote clarity by focusing attention on the provisions within Section 2-326 upon which rest the effective protection for consignors. Also, if a state chooses to enact a sign law, that state is still free to incorporate such a law into its version of the Code by way of a non-uniform amendment. Unfortunately, although these recommendations are good, and the Article 2 Study Group is generally supportive of Professor Dolan's recommendations, the Study Group suggests an approach that defeats the spirit of those recommendations.[171] Of particular concern is the recommendation that the Section 2-326(b) "generally known" exception,

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Professor Dolan is by no means alone in his observations of creditor behavior. *See* Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901 (1986). Thus, the question may not how best to ensure that creditors have the knowledge necessary to extend credit but "whether security interests ought to be enforceable at all." *See* ARTICLE 9 REPORT, *supra* note 10, at 8.

168 *See supra* note 51.

169 ARTICLE 2 REPORT, *supra* note 67, at 43.

170 *Id.* at 44.

171 The Study Group suggests the following revisions:

> (A) Assuming that a consignment for security is governed only by Article 9 and that a "true" bailment is not governed by either Article 2 or Article 9, a "true" consignment should be governed by § 2-326 and, to the extent relevant, the priority rules of Article 9. An effort to distinguish a "true" consignment from a consignment for security should be made in the comments. [footnote: The Study Group agreed that a "sale or return" and a "true" consignment should be governed by the same rules where third parties asserted claims to the goods. Both are non-security consignments for sale.]
>
> (B) § 2-326 should be revised as follows:
>
> (1) The only option for giving public notice should be compliance with the filing provisions of Article 9. Option (a) of § 2-326(3) should be deleted and option (b) should be limited to cases where goods are delivered to an auctioneer for sale.
>
> (2) The phrase "delivered to a person for sale" in § 2-326(3) should be expanded to include all deliveries of goods pursuant to which the parties expect the consignee ultimately to sell to others, even though further processing or prior consent to sale is required.
>
> (3) Clarification of whether the consignee must, as § 2-326(3) now provides, "maintain a place of business at which he deals in goods of the kind involved" should be made. As written, this restricts the scope of protection to third parties. Section 2-326(3) should also be broadened to include delivery to

be limited to auctioneer cases.[172] Such a limitation would eliminate the very provision to which courts have turned in their troubled attempts to vindicate consignors' interests.[173]

The Article 9 Study Committee recommendations follow the Article 2 Study Group's recommendations in many respects.[174] And yet, although the Article 9 Study Committee also recommends the deletion of the "generally known" exception, the Article 9 Study Committee has made the interesting suggestion that Section 2-326 "be revised to exclude from its operation transactions for which requiring the filing of a financing statement (on pain of subordination) would be inappropriate (*e.g.*, the delivery for sale of consumer goods by a natural person or of art by artists)."[175] The Comment to the recommendation posits that

> [i]t is not reasonable to expect most natural persons who deliver their consumer goods to merchants for sale to deal adequately

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and possession by a "merchant who deals in goods of that kind." Compare § 2-403(2).

(4) Consignors who are "consumers" should be excluded from the public notice requirements of § 2-326(3). [footnote omitted]

(5) A seller (as well as a consignor) who delivers on "sale or return" should not be subject to the claims of the buyer's creditors if the seller gives public notice by filing a financing statement.

(C) The Study Group recommends that the Article 9 Study Committee consider the following revisions to § 9-114 and, where appropriate, to other sections of Article 9.

(1) If a consignor has filed a proper financing statement but has not met the additional conditions in § 9-114(1), the priority provisions of § 9-312(5) rather than § 9-114(2) should control. The consignor should not be automatically subordinated.

(2) It should be made clear that priority between a lien creditor and a consignor who files but does not meet the conditions in § 9-114(1) should track the priority rules in § 9-301(1)(b).

(3) It should be made clear that a consignor's interest in the goods attaches to their proceeds and what the priority of the consignor's interest should be.

ARTICLE 2 REPORT, *supra* note 67, at 43-45.

172 *See* ARTICLE 2 REPORT, *supra* note 67, at 45.

173 *See supra* part IV.

174 ARTICLE 9 REPORT, *supra* note 10. For example, the Article 9 Study Committee follows the Study Group in recommending that both the sign law and the "generally known" exceptions be dropped from § 2-326, noting that the sign law is generally unavailable and that "generally known" exception is unreliable. *Id.* at 185-87. The Committee also recommends that "[t]he official comments to § 1-201(37) or § 2-326 should be revised to explain how to distinguish a transaction governed by § 2-326 from a consignment 'intended as security,' which creates a security interest governed by Article 9." *Id.* at 188. In a brief comment on this suggestion, the Committee admits not to have explored "the substance of the distinction," but "believes that revisions to the official comments addressing the issue, perhaps in the context of a PEB commentary, would be useful." *Id.* The Article 9 Study Committee does note that it declines to suggest "major adjustments in the balance that Article 9 now strikes between secured parties and unsecured creditors[,]" despite the evidence that commercial creditors no longer rely on the ostensible ownership of goods in a potential debtor's possession. *Id.* at 9.

175 *Id.* at 187.

> with Article 9's filing and priority rules. Neither is it reasonable to subject the interests of these individuals to the claims of a merchant's creditors in the absence of a realistic means for the individuals to avoid that result. A consignment by a consumer is highly unlikely to be a subterfuge for inventory financing, and professional inventory financiers are unlikely to be materially prejudiced by the lack of notice of a consumer consignment.[176]

The Committee further suggests that "[t]he Drafting Committee may wish to consider whether there are other classes of transactions that warrant exclusion for similar reasons, such as the delivery for sale of art by an artist to an art dealer."[177] In all, the introduction of a natural persons exception would provide artists with greater protection from a consignee's creditors.

The Article 2 Drafting Committee has taken the recommendations of both the Article 2 Study Group and the Article 9 Study Committee and drafted a tentative revision for Section 2-326,[178] incorporating many of the recommendations of the study groups. Of

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[176] *Id.* at 187. Interestingly, the Article 9 Study Committee has recommended more protection for consignors, despite the Study Committee's general support for the Code preference for secured creditors. As the Committee notes:

> [t]here is a tension between bright-line statutory rules, which are easier to understand and administer but which may be both over- and under-inclusive, and more detailed, complex rules, which are relatively more difficult to understand and administer but which seek a more finely-tuned justice. The Committee is sympathetic in principle to the former approach; it is wary of recommending that Article 9 be refined to the point where its intricacy burdens transactions. Nevertheless, the Committee could not always reach a clear consensus as to the optimal levels of generality and specificity in a given context.

Id. at 9 (footnote omitted).

[177] *Id.* at 9 (The Committee, § 25, note 7, acknowledges the prevalence of state art consignment statutes.).

[178] The draft of new § 2-326 (designated § 2-327) reads as follows:

> Section 2-327. CONSIGNMENT SALES AND RIGHTS OF CREDITORS
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> (*a*) Except for consumer goods and goods delivered to an auctioneer, if goods are delivered for the purpose of sale to a person who deals in goods of that kind under a name other than the name of the person making delivery, the goods are subordinate to the claims of creditors of the person to whom they were delivered while in the possession of that person, unless the requirements of subsections (c) are satisfied. This subsection is applicable even if 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".
>
> (*b*) A person making a delivery subject to subsection (a) who complies with Section 9-114(a) has priority in the goods and any proceeds of sale over creditors of the person to whom the goods were delivered to the extent provided in Section 9-114(a).
>
> (*c*) A person making delivery subject to subsection (a) who complies with the requirements for perfecting a security interest under Article 9 but not the requirements of Section 9-114(a) has priority in the goods and any proceeds of sale over creditors of the person to whom the goods were delivered to the extent of a similarly situated holder of a perfected security interest under Article 9.

ARTICLE 2 DRAFT, *supra* note 11, § 2-327.

particular import, the Article 2 Drafting Committee has opted to delete exception (b) and has chosen to draft a consumer goods exception, as opposed to the natural persons exception suggested by the Article 9 Study Committee.

A revision in the Code language governing consignment should reflect many of the suggestions of both the Article 2 Study Group and the Article 9 Study Committee, but differ from the tentative draft Section 2-327 proposed by the Drafting Committee. Building on the recommendations of the Article 2 Study Group and the Article 9 Study Committee, a definition of consignment should supplement either the text of, or the Official Comments for, Section 2-326. Second, Section 2-326 should be amended to define the type of consignor who should merit protection, or possibly the types of consignment, such as art consignment, where the nature of the goods themselves suggests constructive notice for creditors. Third, the notice requirements for creditors under the Section 2-326(3)(b) "generally known" exception should be retained, if not heightened. Each of these three suggestions will provide a filtering process, ensuring not only that those consignors that merit protection receive such, but also that the Code hold creditors to the burden of knowledge that they already bear concerning the transactions of their debtors.[179]

A definition for consignment added to the provisions of Article 1, drawing upon the common law understanding of bailment and agency and Professor Winship's definition of consignment, would clarify the differences between a consignment and a security transaction.[180] Such a provision would strengthen and clarify the role of the definitions section as a preliminary filter, offering courts guidance as to who should and who should not be permitted to take advantage of the consignment provisions. Perhaps equally effective, and less complex, would be a revision of the comments of Section 1-201(37) to reference one or more of the more thorough case definitions of consignment.[181] As a complement, the language of Section 1-201(37) could be clarified by adding the following: "If a transaction purported to be a consignment is intended as

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179 *See supra* note 167.

180 Professor Winship suggests that:

> In the sale or return the buyer is obligated from the time of delivery to pay the agreed price, but in lieu of doing so he may return the goods; if the seller gives credit to the buyer and wishes to secure payment, he should be subject to all the provisions of Article 9.

As a counterpoint, "[i]f a consignee . . . is *not* obligated to pay the price of the goods until sale *and* can return unsold goods . . . the consignment [is] not be intended as security." Winship, *supra* note 94, at 849.

181 *See supra* note 31.

security, a reservation of title thereunder is a 'security interest,' and the transaction is subject to the provisions of Article 9. Otherwise, the transaction is subject to the Article 2 provisions on consignment sales."[182]

Since consignors who manage to have transactions deemed consignments will still fall prey to the pro-creditor provisions of Section 2-326, it is within the section itself that the interest of consignors must be accommodated, particularly by means of subsection 2-326(3)(b), the "generally known" exception.[183] Since the generally known exception has proven itself helpful for consignors who have merited protection, and since consignors tend to lose to creditors despite the fact that creditors often have the greater ability and the inclination to investigate consignees, the exception should be retained.[184] Yet, a creditor should not be burdened with the responsibility for discovering and making provision for the consignment transactions of their debtor's when the consignor himself can adequately assure his own interest. Nor should a creditor be forced into a regime that requires the creditor to litigate every case in which the consignor claims that the creditor had knowledge of the consignment. To accommodate the legitimate needs of both consignors and creditors, what is needed is a middle ground: language that will provide for the consignment transaction and yet still provide creditors protection from the secret lien.

First, the type of consignor to be protected should be defined within the section. Thus, the Article 9 Study Committee's suggestion that natural persons who consign goods should be protected should be incorporated into the text of a revised Section 2-326.[185] This would certainly alleviate the problems consignors confront in certain commercial markets, in which the consignment transaction is a significant, if not the dominant, transactional arrangement between owners and transferees.[186] Also, it would eliminate the problems that would be encountered by artists under a consumer exception. What's more, this additional element should supplement the Article 2 Drafting Committee's inclusion of a consumer

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182 The text of § 1-201(37), as amended in 1987, reads: "Unless a consignment is intended as security, reservation of title thereunder is not a 'security interest,' but a consignment in any event is subject to the provisions on consignment sales (Section 2-326)." U.C.C. § 1-201(37) (1990).

183 Professors Leary and Frisch have suggested that this exception "could protect consignors even against a secured party claiming good faith purchaser status, where dealers in goods of that kind often deal in consigned goods." Leary & Frisch, *supra* note 134, at 458.

184 *See supra* note 167.

185 ARTICLE 9 REPORT, *supra* note 10, § 25, 185.

186 *See supra* note 22 and accompanying text.

goods exception.[187]

Another alternative to elimination of the "generally known" exception would be to draw a distinction between commercial consignors, such as manufacturers and corporations, and individual consignors. The section could include language that would provide that unless the consignor is a natural person or the goods consigned are consumer goods, the "generally known" exception applies. Otherwise, if the creditors knew, or could have discovered by reasonable means, that the consignee dealt in the goods of others, then the owner of the goods prevails.

Such a change in the language of the section, as a supplement to the clarifying changes in the Article 2 Draft, would be far less complex than the existing Section 2-326, yet complex enough to isolate those consignors who merit protection. The two classes of owners are distinguishable in two respects: first, by way of application of the definition of consignment, and second, within Section 2-326, the statute would provide the means for an explicit division of the two types. This would not alter the flow of the case law in the area of consignment, but would simply clarify it, since the courts already treat individual- and consumer-consignors differently from manufacturers, applying the consignment provisions of the UCC stringently to manufacturers and corporations.[188]

Additionally, as the Article 9 Study Committee noted, "professional inventory financiers are unlikely to be prejudiced by the lack of notice of a consumer consignment."[189] In essence, the monetary value of the natural person or consumer consignment to the

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187 *See supra* note 178.

188 *See In re* Flo-Lizer, Inc., 946 F.2d 1237 (6th Cir. 1991) (finding for creditor, court responded to "unfair hardship" argument of consignor by stating that where consignor sought return of $500,000 in chemicals delivered to debtor, court found that "[a]s a sophisticated commercial actor . . . Ciba-Geigy was aware that it could forestall . . . calamities [such as loss of the goods and their value] by taking the relatively inexpensive step of filing the appropriate financing statements).

In *Logan Paving Co. v. Massey-Ferguson Credit*, 323 S.E.2d 259 (Ga. Ct. App. 1984), the court held that a creditor, having filed proper security agreement covering after acquired property, had priority over owner who delivered a tractor for sale and failed to file according to § 2-326(3). *Id.* at 261. The court distinguished *Allgeier* as interpreting § 2-326(1), whereas in this case § 2-326(3) was deemed in issue. *Id.* at 260. The facts of the case, although concerning a single unit and a consignment transaction, were different in that in *Logan* the owner had a history of financing the dealer. However, the court did note that if an owner can show that a creditor had no right to assume ownership, the owner can prevail, but insisted the owner use the test of § 2-326(3)(b) to do so. *Id.* at 261.

See also In re Tristar Automotive Group, Inc., 141 B.R. 41 (Bankr. S.D.N.Y. 1992); Evergreen Marine Corp. v. Six Consignments of Scallops, 806 F. Supp. 291 (D. Mass. 1992); *In re* Bildeco, 11 B.R. 1019 (C.D. N.J. 1981) (finding for creditor as against Gerber Industries, court finds that regardless of characterization of transaction as purchase money security interest or as consignment, no notice was given to creditors).

189 *See supra* 176.

creditor will, in most circumstances, amount to only a small portion of the available collateral. Thus, the benefits to consignors that will be achieved at the expense of creditors, at least in the area of secured credit, outweigh the increased burden placed upon creditors.

VI. CONCLUSION

The problems confronting the consignor of goods are merely one outgrowth of the ongoing legal conflict between owners of goods and creditors. In the area of consignment, and throughout the commercial law, the UCC attempts to manage the conflict, largely by favoring creditors over owners. Despite the Code's preference for creditors, and the clear import of Section 2-326, which is to narrowly define the rights of consignors, a pro-owner equity has found its way into the case law. Courts have indeed been inventive in their defense of the hapless consignor. Yet, as Grant Gilmore suggests, when courts fail to "appreciate" the reasoning behind the Code, we are obligated not to heap criticism upon those courts, but to listen to what those courts have to say.[190] For while courts may arrive at a decision by way of questionable, if not downright subversive, interpretations of Code language, they are right in result for all the wrong reasons. The decisions point to weaknesses in the Code in the area of consignment that have not been, but must be adequately addressed.[191]

When we do listen to what the courts, the legislators, and the commentators, are saying, we find that the Code fails to properly regulate the consignment transaction. Unfortunately, even though many state legislatures have attempted to preempt the Code in the area of art consignment, their efforts have achieved mixed results, often leaving the art consignor with little protection against the art dealer's creditors. The inadequacy of both the Code and state law in the area of art consignment suggests that a broad reworking of the consignment provisions is in order. In light of the fact that not only art consignors but other types of consignors of goods who merit increased protection are adversely affected by the Code provisions as they stand, and would find themselves in an even worse position relative to creditors if the Drafting Committee's draft is enacted in its present form. The revision process must not stop with the draft recommended by the Article 2 Drafting Committee.

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190 *See* Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L.REV. 605 (1981).

191 *See supra* note 131.

The process must continue until the UCC consignment provisions reflect not only a concern with the rights of creditors, but also a fair consideration of the rights of consignors. The provisions must be amended to allow owners of goods broader protection from a consignee's creditors. The recommendations of Part V of this Note suggest a means by which to protect both creditors and consignors by means of an exception for both natural persons and an exception for consignments of consumer goods. Combined with the addition of a definition of consignment in the Code, will provide the means to distinguish commercial consignors from the class of consignors and consignments that merit protection. This would ensure that commercial consignors, who possess the means to protect their interests against competing claims to their goods, receive no greater protection against creditors then Code now allows.

Codification of such a distinction within Section 2-326, even if imperfect, will be an accurate recording of the treatment of consignment that has occurred over the past hundred years and will likely continue. The alternative—the elimination of the very provision that allows for protection of consignors' rights as well as the vehicle for drawing distinctions between commercial and natural person and consumer goods consignment—will leave in place a Code that will be original, but not accurate, and will leave a large class of consignors without adequate protection against consignee's creditors.

Mark Marcone