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CONSIGNMENT DISTRIBUTION UNDER THE UNIFORM COMMERCIAL CODE: CODE, BANKRUPTCY AND ANTITRUST CONSIDERATIONS

RICHARD W. DUESENBERG*

INTRODUCTION

Selling goods for a profit is the first objective of any merchandise distribution system. It must be. At least as far as American business is concerned, the patterns for accomplishing this assignment defy clear-cut definition or diagramming. There is no single vehicle; no single concept.

Lawyers advising major wholesale suppliers early become familiar with the suggestion that goods be put into the market place "on consignment." Marketing personnel commonly believe that the "consignment" is a solution to many of their commercial problems—credit, territorial saturation, customer solicitation, pricing, and others. The experience of this writer, however, in advising on more than a few large-scale programs for the marketing of both new and established products is that most distribution experts, as sophisticated as many of them are in the complex challenges of their trade, are amazingly imprecise in their conception of a consignment transaction. They ask for it; but they are unaware of its features. Frequently they seek to utilize a consignment for security purposes; but they do not wish to assume the burdens of that classification. Sometimes they intertwine legitimate and—quite innocently—illegitimate control objectives in requesting a consignment transaction. Whatever the reason for a consignment, it usually does not take long to discover that the client's image of the transaction is fuzzy. Nor is the law a monument of clarity. Consignments have been in the courts a long time, and the business conditions helping to shape the judicial temper have varied considerably. What the courts have said about consignments over the years has not been consistent, and this no doubt has affected the commercial use of the term.

The purpose of this Article will be to review briefly certain of the legal aspects of consignment distribution as affected by the Uniform Commercial Code. Bearing upon this topic will be certain collateral considerations of judicial law-making in the areas of antitrust and bankruptcy law.

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APPLICABILITY OF ARTICLE 2 OR ARTICLE 9

Code History and the Test of Intent

Any business plan intending to use consignments to distribute goods for ultimate sale must take into account certain problems stemming from recent antitrust decisions and from correctly placing the transaction within either Article 2 or Article 9 of the Uniform Commercial Code.

Regarding the latter, several sections of the Code make it clear that using the words "on consignment" in delivering goods gives no assurance that the transaction will fall within the consignment section of Article 2 and escape the secured transaction prescriptions of Article 9. Code language itself is of little assistance in assessing the proper placement of a given "consignment." Rather, the Code makes the *intention* of the parties the predominant test. Intention becomes the operative element not from what is said of consignments in the sales article, but rather from two other Code sections, one in the general provisions of Article 1 and the other in Article 9. In describing the boundaries of the secured transactions article, Section 9-102 states that "This Article applies to security interests created by contract including . . . consignment intended as security."¹ And again in Section 1-201(37) where the term "security interest" is defined, it is written that "unless a . . . consignment is intended as security, reservation of title thereunder is not a 'security interest' but a consignment is in any event subject to the provisions on consignment sales (Section 2-326)."²

1. The quoted portion is taken from subsection (2) of § 9-102 of the Uniform Commercial Code [hereinafter cited as UCC] which reads in its entirety as follows:

(1) Except as otherwise provided in Section 9-103 on multiple state transactions and in Section 9-104 on excluded transactions, this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts, or contract rights; and also

(b) to any sale of accounts, contract rights or chattel paper.

(2) This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in Section 9-310.

(3) The application of this Article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply.

2. The definition of "security interest" in UCC § 1-201(37) reads:

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in effect to a reservation of a "security interest." The term also includes any interest of a buyer of accounts,

How important it is to assign intention as the test for determining the applicable Code article is fully understood when one grasps the marketing objectives for using a consignment. Some of these objectives will be noted shortly. For now, observe simply that intent, and not any subjective purpose of the parties, is the test of whether a consignment falls within Article 2 or Article 9 of the Code. No provision directs, for example, that because a consignment to a merchant is for sale to the latter's customers, the sale necessarily must be classified as a security agreement and thus come under Article 9. The impression comes easily, of course, that a delivery of goods to a merchant under a consignment-type title-retention contract where the goods are delivered for sale is merely another specie of a secured transaction. This is what the transaction on the surface most approximates, and, as the argument goes, if the secret interests of the supplier are not to be asserted against unknowing creditors of the consignee, Article 9 and all its condemnation of a secret ownership claim should apply to the transaction. After all, that is the purpose of the article on secured transactions.

This argument, however, fails to accommodate the vital utility of consignment contracts in commerce. The fact is that consignments are used abundantly for product distribution and in many cases financing is not the prime consideration. If these other commercial considerations are not to be scuttled, it is important that the intent test be made capable of tolerating these legitimate commercial objectives. Only then will the consignment as a viable distribution vehicle not be challenged by the Uniform Commercial Code.

While intent as a test may lack desirable specificity, it has the attribute of allowing numerous possibilities for the use of consignments. The first route taken by the Uniform Commercial Code was not so accommodating. As originally promulgated, the Code in effect provided that all consignments created a security interest, and were governed by the provisions of Article 9. True, there was a consignment section in

chattel paper, or contract rights which is subject to Article 9. The special property interest of a buyer of goods on identification of such goods to a contract for sale under Section 2-401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with Article 9. Unless a lease or consignment is intended as security, reservation of title thereunder is not a "security interest" but a consignment is in any event subject to the provisions on consignment sales (Section 2-326). Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

Article 2, but the only purpose served by this section as it first appeared⁸ was to define "sale or return" and "sale on approval" transactions, and to provide that any delivery of goods on consignment would amount to "sale or return" unless certain steps establishing notoriety were taken. It derived no help from ancillary sections that might keep what shall shortly be described as a true consignment in the confines of Article 2.

This all-or-nothing approach of the earlier language encountered difficulty when the Code was subjected to the intense analysis given it especially by scholars of the practicing bar before the New York Law

3. The following is a comparative quotation of UCC § 2-326, with italics showing additions made after the 1952 final draft and brackets showing deletions from that draft:

Section 2-326. Sale on Approval and Sale or Return; *Consignment Sales and Rights of Creditors.*

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

(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 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.*

[(2) There is a contract for sale or return when goods are delivered to the buyer for resale and are charged at a fixed price but even though they conform to the contract are returnable against recredit or repayment of their price in full or less minor charges.]

(3) Where [the buyer has] *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" [or other words purporting to reserve title to the seller until payment or resale are insufficient as against the buyer's creditors to keep the transaction from being a sale or return unless]. However, this subsection is not applicable if [the seller] the person making delivery*

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

(b) *establishes that the [buyer] person conducting the business is generally known by his creditors to be [primarily] substantially engaged in selling the good of others, or*

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

[(3)] (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).

Revision Commission.⁴ Old sections were polished up in several respects. The narrow thinking behind the original language had caused the drafters of the Code to talk in terms of deliveries to a *buyer* "on consignment" for *resale*. Both the reference to *buyer* and to *resale* were manifestations of the antipathy of the drafters toward consignment transactions, and should never have been put into the section. A true consignment is not a sale; it is an agency. The consignee is neither a buyer nor one taking delivery for resale, and he holds the goods for sale only on behalf of the consignor, not as a reseller. This conceptual error was corrected in the current version of Section 2-326(3), which now refers to a delivery "to a person for sale"⁵ making such a delivery a sale or return unless words such as "consignment" are used and one or more of the protective steps of the section are satisfied.

More important, however, was the major shift in principle accomplished by deleting the language of former Section 1-201(37).⁶ That section had defined as a security interest any reservation of property by a seller or consignor. Certainly a consignor "retains title," and if "reserves title" is the equivalent, then the older language defined every consignment as a security interest, thus placing the transaction within Article 9. Not only did the old language build into the Code an inconsistency between Section 2-326 and Article 9,⁷ but it effectively deprived the business community of a useful marketing device. If every consignment created a security interest, then it had to follow that the underlying transaction was a sale—albeit clothed in consignment language. And denominating the underlying transaction a sale would be lethal to many of the consignment's commercial attributes.

By shifting from the former absolutist approach to the intent concept, the new Code language did not restore the malignancy of pre-Code law in allowing consignments to be used as secret liens. The goal of the

4. 1 N.Y. LAW REVISION COMM'N, STUDY OF THE UNIFORM COMMERCIAL CODE 436 (1955).

5. See note 3 *supra*. Notice that in the second sentence of subsection (3) of UCC § 2-326, the original concept of delivery for resale continues its influence, the amendment failing to have included sale along with resale.

6. UCC § 1-201(37) formerly read:

(37) "Security interest" means an interest in property which secures payment or performance of an obligation. The reservation by a seller or consignor of property notwithstanding identification of goods to a contract for sale or notwithstanding shipment or delivery is a "security interest." The term also includes the interest of a financing buyer of accounts, chattel paper, or contract rights.

UCC § 1-201(37) as it currently reads is set out in note 2 *supra*.

7. By defining any reservation of property by a consignor as a security interest, UCC § 1-201(37) rendered UCC § 2-326 inconsistent with Article 9 in several respects. Most important would have been the conflict of Article 9 filing provisions with § 2-326(3)'s provisions concerning compliance with state sign statutes and establishment of the consignee as being generally known to deal in other party's goods.

original Code approach was to eradicate the misuse of consignment as a financing transaction kept secret from other creditors of the consignee. These creditors now find their protection, in the case of a true consignment, in the provision that any delivery "to a person for sale" is classified as a "sale or return" where the deliverer "maintains a place of business at which he deals in goods of the kind involved."⁸ Goods held on sale or return are subject to claims of the buyer's creditors while in the buyer's possession.⁹ This conversion of a consignment into a sale or return does not apply, however, where one of the protective measures of Section 2-326(3) is taken.¹⁰ These measures are basically ones of publicity, and have the effect of eliminating the repugnant secrecy which surrounded consignments in so many pre-Code examples. The penalty of failing to satisfy one or more of these protective steps is to lose in competition with other creditors of the consignee. Where the consignment is not a "true consignment," or phrased differently, where it is intended as a security agreement, then the creditor's protection is found through Article 9. The result is about the same¹¹—defeat of the consignor in a contest with creditors of his customer.

Pre-Code Analysis of Consignment Transactions

Consignments have not had a sympathetic press, either in judicial opinions or legal literature. This is because their history bears witness to an extensive use as a substitute for some form of security agreement in an attempt to avoid burdens a creditor did not wish to assume. The requirement of filing, laws voiding security interests where collateral was allowed to be sold, and other rules, all contributed to the phenomenon which saw "consignment selling" attempted through most of the first half of the 20th century as a form of security agreement which would avoid all or certain of these obstacles,¹² and stand firm against the claims of the debtor's other creditors.

Though consignment is still a popular commercial marketing vehicle, its use strictly as a form of security is no longer widespread. Intervening development of chattel security devices did away with the need to resort to the consignment concept to achieve certain results. Resale authority ultimately became respectable, if not in the conditional sales or chattel mortgage law¹³ of a given state, then through the trust receipt—common

8. UCC § 2-326(3), quoted in note 3 *supra*.

9. UCC § 2-326(2), quoted in note 3 *supra*.

10. See text accompanying notes 82-85 *infra*.

11. See text accompanying notes 82-87 *infra*.

12. The predecessor of the consignment was the 19th century factoring arrangement. See Steffen and Danziger, *The Rebirth of the Commercial Factor*, 36 COLUM. L. REV. 745 (1936).

13. *E.g.*, former N.Y. Pers. Prop. Law, § 69 (conditional sales) and former N.Y. Lien Law, § 230-a (allowing resale of mortgaged inventory).

law¹⁴ and statutory¹⁵—or a factoring arrangement.¹⁶ And of course, resale of collateral is unequivocally blessed under the Uniform Commercial Code and does not impair validity of a security agreement in any way. What happened to consignments when they came to courts as disguised security transactions lives on as relevant law, however, to the use of the same device today.

What did happen to consignments? The story is familiar to students of commercial law. The legal arguments juxtaposed against each other were, generally, on the one hand that the transaction cast as a consignment was in reality a conditional sale; and on the other hand that the terms of the agreement distinguished the transaction from a conditional sale and made it a consignment. Case after case may be cited as examples, some occasionally reflecting ingenious attempts at draftsmanship to avoid the transgressions of earlier agreements unlucky enough to have found their way to the courthouse. Those consignments which were found valid generally came to be referred to as “true consignments,” whereas the condemned were usually classified as conditional sales contracts¹⁷ or merely fraudulent transactions *visa-vis* creditors.¹⁸

Since the history determining what saved and what condemned a consignment transaction remains important under the Uniform Commercial Code, brief reference should be made to some characteristics of a true consignment. By no means were the fact patterns litigated all the same; variances reflected differing circumstances, differing skills of draftsmanship, and different judicial attitudes. On the whole, however, the typical consignment contract litigated in the first third of this century contained provisions

- a. retaining title in the consignor;
- b. requiring the shipping invoices to refer to the goods as consigned goods;
- c. authorizing the consignee to sell the goods at a specified price or at no less than invoice price;
- d. requiring the consignee to keep the goods segregated from

14. *E.g.*, *In re James, Inc.*, 30 F.2d 555 (2d Cir. 1929).

15. On the effect of the passage of the Uniform Trust Receipts Act, *see* Bogert, 3 U. CHI. L. REV. 26 (1935).

16. *E.g.*, former N.Y. Lien Law, § 45.

17. *E.g.*, *D.M. Ferry & Co. v. Hall*, 188 Ala. 178, 66 So. 104 (1914) (obligation to pay if not sold by certain date rendered agreement a sale or return); *In re Aronson*, 245 F. 207 (D. Mass. 1917) (“Whether an arrangement is a consignment, a conditional sale, or a sale on credit depends less on how it is described by the parties than on the rights and liabilities created by it”).

18. *E.g.*, *In re Harrington*, 212 F. 542 (D. Mass. 1914); *In re Edwards*, 163 F. Supp. 935 (N.D. Cal. 1958) (goods consigned allowed to be commingled with those owned and no requirement of remitting proceeds led to defeat of owner).

- wholly owned goods or goods otherwise in his possession under some claim of ownership interest;
- e. requiring the consignee to hold all cash or other proceeds from the sale of the goods in trust for the consignor or to forward the same immediately on receipt;
 - f. requiring the consignee to keep separate records of goods received on consignment and of consigned goods which were sold;
 - g. requiring a weekly or monthly accounting, and empowering the consignor to inspect the consignee's records at any reasonable time;
 - h. authorizing the consignor to request the goods back and obligating their return by the consignee on such request; and
 - i. allowing the consignee to return any unsold merchandise without obligation.

Obviously, not all of these were of equal importance in determining the nature of the transaction. Even though title was the concept lawyers utilized in couching a transaction in consignment language, and though some judicial language attached importance to the location of title, it was not generally the determinative clause. Nor could it have been. If there was any substance at all to the argument that a consignment as a disguised security interest was a fraud on other creditors, then the validity of a consignment could not be tested in title analysis. It would be too easy to provide that title did not pass, and to express this as the intent of the parties.

If any of the above provisions ascended higher than others in importance it was that the consignee would have the right to return the goods which were unsold.¹⁹ Without this right, the transaction was almost certainly doomed as a conditional sale, invalid against the creditors because, generally, unfiled or unrecorded. Even this clause, however, was not the ultimate distinction between the "true consignment" and the fake. The telling test was generally stated in terms of agency, and required not only the existence of most or all of the terms listed above, but also compliance with them in the conduct of affairs between the consignor

19. *E.g.*, *In re Thomas*, 321 F. 513 (S.D. Ga. 1916) (fact that consignor could take back the consigned goods or compel payment if the goods were not sold within six months held not to create an obligation on consignee to pay until option exercised, and therefore, other factors being satisfied, transaction was a consignment); *Fowler v. Pennsylvania Tire Co.*, 326 F.2d 526 (5th Cir. 1964) ("The prime distinguishing factor of a consignment as opposed to a sale is that after the goods have been delivered to the dealer, no obligation arises on the part of the dealer to pay for them.").

and consignee.²⁰

It was proper that the courts should not have made the right of the consignee to return the goods the only important ingredient of a consignment. To have done so would have overlooked that another well-accepted transaction—the sale or return—would achieve the same commercial objective of allowing a return of merchandise. Few courts obscured as between the sale or return²¹ and a consignment their real distinction, which is premised in the result of the former being a sale giving rise to a debtor-creditor relation, with the latter in pristine form being neither of these. True consignment is true agency, for “the very term implies an agency, and the title is in the consignor, the consignee being his agent.”²² For this reason, by most courts, “the real character of the agreement [was] determined from all the circumstances, notably from the conduct of the parties, rather than by express statements of a written contract.”²³ If the consignee were permitted to act outside the authority of the agency agreement—that is, to act as the owner of the goods—the agency (consignment) frequently failed and the consignor lost control over the goods.²⁴ The inability of the consignee to return the goods under the agreement was an inconsistency with the term “consignment” which resulted in a conditional sale, but the consignee’s unrestrained acts of commingling proceeds,²⁵ mixing consigned goods with goods owned,²⁶

20. *E.g.*, *Libeowitz v. Voiello*, 107 F.2d 914 (2d Cir. 1939) (quoted in text accompanying note 23 *infra*). Courts have varied considerably in their emphasis on the parties’ conduct, however, and many cases may be found which emphasize the words used unless there was evidence of an intent to defraud creditors at the time of executing the agreement. *E.g.*, *Fowler v. Pennsylvania Tire Co.*, 326 F.2d 526 (5th Cir. 1964), where the court said that conduct is examined to determine whether the parties actually intended to effect a consignment or to conceal a sale, and added that the prevailing view is to determine intent solely by the words used in the written instrument.

21. Sellers would in all cases prefer a sale or return if in every case payment were made on delivery. Unfortunately, that is not the case, since short term credit is the rule rather than the exception in many lines of commerce. Without a separate security agreement, a seller using sale or return would end up a general creditor if bankruptcy occurred between the time of delivery and the date for payment.

22. *Rio Grande Oil Co. v. Miller Rubber Co.*, 31 Ariz. 84, 250 P. 564 (1926); *In re Galt*, 120 F. 64 (7th Cir. 1903).

23. *Liebeowitz v. Voiello*, 107 F.2d 914 (2d Cir. 1939).

24. *E.g.*, *In re Handy*, 218 F. 956 (D. Md. 1915) (fact that agent never turned over proceeds or followed contract provisions as to accounting and consignor assented thereto showed parties did not intend agency); *Taylor v. Fram*, 252 F. 465 (2d Cir. 1918) (“The nature of the transaction . . . is not to be determined from the written agreement . . . for they did not keep it. It is more important to know what they did than to know what they agreed they would do. . .”).

25. *Yarm v. Lieberman*, 46 F.2d 464 (E.D.N.Y. 1931) (consignment intention held abandoned because, *inter alia*, parties allowed commingling of proceeds).

26. *Taylor v. Fram*, 243 F. 733 (E.D.N.Y. 1917) stated that:

A transaction which is in form and effect, so far as the public is concerned, a sale, but which the apparent vendor alleges to be not a sale, but a bailment, will be treated and considered as passing title to the goods in question to the bankrupt: [(1) if fraud is shown in the original contract of agency, (2) if

setting the price,²⁷ failing to account,²⁸ and others,²⁹ were in many instances inconsistencies with the agency concept which also had the same result.

Learned from the history of the consignment in pre-Code cases is that the transaction was neither more nor less a consignment because of the subjective intention of the parties. Rather, what controlled was the terms of their agreement coupled with conduct in accordance with the terms. This is an objective test. If certain terms were present and certain conduct did not betray their adherence, the consignor usually had few problems with claims of competing creditors. Otherwise, he did.

Agency as the Test of Intention

But how should the intention test of the Code be developed? Several possibilities exist. One is to construe a consignment as intended or not intended for security depending essentially on the function for which the consignment was entered. This view has led to the suggestion that there are two ways in which consignments are used: as vehicles for the marketing of goods and as price-fixing devices.³⁰ Under the former, the consignment would be regarded as a security agreement. Under the latter, it would not.³¹ The second approach under the intent concept is to

conduct is such as to estop from denying the legal effect of the acts, and (3) where there has been a breach in the contract sufficient to indicate that the consignee was not carrying out the contract of agency, and where the consignor has then so acted upon the breach as to show, with respect to future consignments, that title passed in the transaction and that they were sales instead of bailments.

27. *E.g.*, *Union Furniture Co. v. Goetz*, 67 F.2d 201 (7th Cir. 1933) (holding that allowing the consignee to sell at any price it chose, so long as it remitted a fixed amount, showed a sale). *Cf. In re Eichengreen*, 18 F.2d 101 (D.C. Md. 1927) (where it was stated that deliverer's authority to sell at any price did not necessarily show sale so long as he had the right to return goods without obligation to pay).

28. *E.g.*, *In re Staughton Wagon Co.*, 231 F. 676 (6th Cir. 1916).

29. If parties intend a consignment, they should identify themselves accordingly. Describing themselves, respectively, as seller and buyer is sloppy and damaging drafting if a consignment is intended. *In re United States Elec. Supply Co.*, 2 F.2d 378 (S.D. Ill. 1924).

30. *Hawkland, Consignments Under the Uniform Commercial Code: Sales or Security?*, U.C.C. COORDINATOR 395, 397 (1963).

31. One of the most astute commentators on the Code has stated that the question of placing a consignment under Article 2 or Article 9 can be resolved easily in most cases by concentrating on the function to be performed by the consignment in the particular situation. We have seen that consignments are used in two ways; as concessions to dealers who are unwilling to assume the risk of finding a market for the goods, and as price-fixing devices. The first use is clearly a secured transaction with the reservation of title to the goods acting as collateral. The second use has nothing to do with security. Since it is designed only to insure resale price maintenance, it would be unfair, illogical and unworkable to impose all the elaborate security rules of foreclosure, priorities, redemption and the like on this type of transaction. Conversely, the first use cannot be fairly handled unless *Hawkland supra*, note 3, at 403, rules are imposed.

The present writer has previously stated his disagreement with this view of his former

analyze the transaction in the same manner as courts have been doing for decades, namely, under the concept of agency. The agency status of the transaction is submitted as the proper test.

Undoubtedly it is a commercial fact that consignment arrangements are rarely entered solely for one purpose. The impression gained from reported opinions may be to the contrary, but this results essentially from the context in which the consignment issues are presented. A defunct consignee situation leads all too often to litigation. The trustee in bankruptcy is a once-on-the-scene person, who fights to the bitter end to retain or acquire an interest in consigned goods as an asset of an insolvent estate. He has little commercial reason to compromise, no business purpose or business relation to protect, and is therefore a most difficult person for a disappointed consignor to negotiate with. Resolution of dispute is more likely to have to come from an outside decision-maker, usually the courts, than from the interested parties themselves. On the other hand, price-fixing consignments have of late been cherished targets of aggressive government lawyers, not because of the consignment principles involved, but for the alleged anti-competitive impact of the price-fixing ingredient. In view of the limited objectives of the contestants, the suspicion is strong that reported cases do not portray an accurate picture of the commercial use made of consignment transactions.

Many commercial objectives can be well-served through the consignment. Price-fixing³² has been only one of them. Until the advent of trust receipt financing, the modern factors lien laws, and the abolition of conceptual burdens on traditional chattel mortgage law, secured financing was another, perhaps even the most common. But these are only two; there are many others.

In determining the utility of a consignment transaction, much depends upon general business conditions, and the circumstances of the respective parties. It may be that 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 deliverer assumes a minimum of risks or none at all, except for negligent handling of the goods. Even a sale or return is not attractive to the dealer. At the very least it creates a debtor-creditor relation. This affects the business' debt-to-equity ratio and in turn its ability to raise finances for other business purposes. The fact that goods held on sale or return may be sent

colleague. R. Duesenberg & L. King, SALES AND BULK TRANSFERS UNDER THE U.C.C., ch. 11, "Consignments and Other Deliveries Retaining Control in Seller," (1966); this present paper is an expanded commentary, with greater emphasis on business and antitrust considerations.

32. For the impact of antitrust principles where there is a price-fixing objective, see text accompanying and following note 45 *infra*.

back for full credit is not usually of much assistance, because potential lenders look at the debt position at the time money is being sought more than as of a time somewhere in the future. A merchant unwilling to accept any risks other than the minimal due care with respect to goods may be induced to take the goods into stock under terms which retain title, risk of loss, and most other obligations and burdens with the supplier, together with the uncompromised right to return the goods at any time if they are not sold. The attributes of the consignment in this context are self-evident—not as a gimmick to deceive creditors but as a device to serve important business ends.

On the other hand, it may be that it is the distributor or dealer who is desirous of taking into inventory certain merchandise of a manufacturer or other supplier, but whose financial condition may be such that severe difficulties are encountered in finding anyone willing to deliver to him. Perhaps a supplier is willing to deliver, but not pursuant to any contract of sale. This is a traditional context for the consignment transaction. In the past this was usually accompanied by a desire to avoid public filing or to circumvent local rules impairing inventory chattel security transactions because of the necessity of allowing resale and/or retention of part of the proceeds of their disposal. While neither of these continues today as a forceful reason for resort to the consignment,³³ the rather large structure of elaborate rules surrounding secured transactions gives good cause for bypassing the sales-security route in favor of an agency-consignment in some extreme situations. Foreclosure laws are often troublesome to comply with, and priority rules even under the Code³⁴ are not the surest foundation for judging one's rights in goods or their proceeds. In addition, the -500 series of Article 9 contains numerous protective sections for the debtor which are not alterable, and which a supplier of goods may wish to avoid.³⁵ The right to compel resale of repossessed goods and the right of a debtor to the proceeds of resale that are in excess of his indebtedness, as important as they are for the

33. See text accompanying notes 12-16 *supra*.

34. For a thorough discussion of priority problems under the Code, see GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, ch. 26-29 (1965), and COOGAN, HOGAN & VAGTS, SECURED TRANSACTIONS UNDER U.C.C., ch. 7A (1967).

35. So long as a transaction is not deceptive and a fraud on third parties, the writer knows of no persuasive reason why the parties to a contract may not willingly agree to a form of agreement which does not fall within Article 9, and therefore which avoids the unalterable remedies provisions of that article. To be sure, those sections are designed in large part to protect the interests of the debtor for good policy reasons. But the notion that debtors are always the ones in need of legislative protection is quickly dispelled with exposure to the realities of the commercial world; if the parties knowingly desire to avoid these protective measures, if due protection is afforded third parties, and if the delivering party in fact insists on conduct under the agreement that would show an agency relationship, little but an emotional attachment to the policy behind the -500 series of Article 9 remains for arguing that those sections may not be avoided.

protection of debtors, are nevertheless sources of potential friction. As such, they form legitimate commercial reasons in occasional cases for avoiding a sale and secured transaction. In such instances, a consignment is the clear alternative. This is true for the supplier of goods, as well as for the one supplied. The once valid objection based on deception of third parties fades into history in view of the Code requirement of notoriety.

More sophisticated reasons than those just noted exist, however, for employing consignment as a distribution vehicle. To take just one example, consider the problems of a manufacturer of a new product, useful in several areas, but untried and untested, and requiring a large multiplying factor to get into the hands of the consumer. The manufacturer may envision several different markets for the product. One market may require considerable service; another may not. One may be made up of large and financially responsible buyers; another may be just the opposite, and still another may be both. In one market the buyers may be highly experienced, sales-resistant professionals; in another the characteristics may be different. If the product is new and unique, but not patentable, getting lead time on a potential competitor could be very important to the success of the projected venture. All of these and many other factors may play a part in determining what market strategy to use to gain valuable lead time, to maximize market entry and to establish product acceptability. The interest of speed would probably not be served by attempting to create an internal marketing force, though this may be a manufacturer's ultimate objective.

The consignment device can be very useful for overcoming some or all of these problems. Through it major strides can be taken toward assuring adequate and proper servicing of a product. Concentration in a given market, whether defined by geography or type of customer, might be most rapidly and effectively accomplished by working through an existing organization with high penetration. In the consignment is found the legal paraphernalia to make relatively certain that the geographic or customer saturation objective of a manufacturer is being achieved or at least attempted. Subject to developments of antitrust law which may have a paralyzing effect,³⁶ consignment also allows the manufacturer to establish a pricing system relatively free from erosive pressures—a point of no mean significance until the decision to go it alone or to market through independent distributive channels is made.

Service, stability of price, customer and territorial saturation—all of these are highly significant considerations in planning business strategy for the introduction of new products. But the utility of a consignment is

36. See text accompanying notes 52-62 *infra*.

not restricted to such circumstances. Many established products require careful or highly technical service at the time of sale or even after, perhaps in connection with the application of the product to its intended use, for installation, or any number of other purposes. Defective service may be a matter of grave concern in light of developing product liability law. Another possibility is that different grades of a given product might best be used for different purposes. While interchange may be possible, the public image, especially of a new product, could be seriously impaired if poor results should flow from use of less than the optimum grade for a specific purpose. If goods are sold to distributors or dealers for resale, a good measure of the control necessary to overcome these burdens is lost, for with sale goes the implied license to use or resell the product according to the purchaser's own choosing. To be sure, some measure of protection can be achieved by framing a product warranty to be applicable only under certain uses, or by contracting that a distributor or dealer render certain services or concentrate in primary markets; but these are not nearly as effective as being able to tell the party carrying the product to the marketplace where, how, and for what purpose it may be sold.³⁷

Most objectives attainable through consignment may also be accomplished through a marketing force which is part of a supplier or manufacturing firm. But the cost in time, money and effectiveness may be such that the consignment route is considerably more attractive. To develop an in-house distribution system of employees means not only consuming valuable lead time but also taking on the many problems of personnel management; hire and discharge, labor management issues, the high cost of fringe benefits and indirect payroll, and others, all of which may be sidestepped through a system of independent agents. Huge capital investments, as in warehouses, may also be by-passed by use of a consignment program. To be sure, the circumstances of every case must be closely examined; but these are positive points of a consignment system of distribution.

Which of the wide variety of purposes is behind a decision to enter a consignment transaction should be of only secondary importance in determining the Code consequences. Of first concern should be whether a true agency agreement was entered and consummated. No convincing reason is apparent why a merchant should be able to avail himself of a consignment for price control, but not to get at the consigned goods in the

37. Nothing in this should be read as indicating that a purchaser in the ordinary course of business either should not or would not get good title, in the event of an unauthorized sale. UCC § 2-403, which supersedes to a large extent the common law concept of estoppel, gives such a buyer adequate protection. For a complete discussion, see R. Duesenberg & L. King, *SALES AND BULK TRANSFERS UNDER THE U.C.C.*, ch. 10, "Title and Claims of Third Party Purchasers," (1966, 1968).

event of the consignee's financial failure. Before adoption of the Code, admittedly, there was nothing but the agency relationship—and precious little in that—which might alert the consignee's creditors to the fact that the goods in the consignee's possession were not his. But the Code now requires a protective step of notoriety, failing which the consignor will lose control of the goods as against the consignee's creditors. In going the route of consignment, the consignor gives up rights of considerable value and also assumes important commercial burdens. Since there are valid commercial purposes for using a consignment rather than a sale-secured transaction arrangement, the test of intention in determining whether a consignment comes within Article 2 or Article 9 should be the objective one of agency and compliance with the terms of the agency, and not one of subjective inquiry into the purposes of the parties.³⁸ How was the transaction tailored, and whether the degree of control which the consignor exercised over the goods and over the consignee was consistent with an agency-bailment concept—these should be the crucial questions.

Agency Test Consistent with Code

Nothing in the language of the Uniform Commercial Code rules out using the agency analysis in determining the intent of a consignment. That the original version of the Code treated all consignments as secured transactions is certainly no basis for rejecting an agency test. Not only is the former provision now deleted, but in discarding it, the draftsmen were silent about distinguishing between consignments intended for price control, market saturation, avoidance of restrictive remedies of secured financing, or anything else. Substituted for the former language was simply a provision that consignments intended as security would come within Article 9; others would not. The distinction would seem to be between a "true consignment" and one which was merely a subterfuge for another transaction. If the transaction were intended as a true consignment and did in fact create an agency relationship that was performed, then it should not come under Article 9, but rather under Article 2, where considerably more latitude is given for shaping the rights and remedies between the parties. Had another result been intended by the deletion, it would have been more appropriate and better drafting to continue the

38. Cf. 1 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 338 (1965): It is clear enough the "intended" [under Section 1-201(37)] has nothing to do with the subjective intention of the parties, or either of them. Under the pre-Code case law on consignments, the dividing line between "true" and "false" was drawn with reference to the consignee's right to return unsold goods to the consignor; if he had the right, the transactions was a true consignment; if he became absolutely liable for the price of goods "consigned", with no right to return unsold goods, the transaction was treated as a security transaction of some sort. The same results will follow under the Code.

previous language, excepting therefrom consignments with certain limited purposes.

Furthermore, it should be noted that agency does not create a debtor-creditor relation. "Security interest," on the other hand, as that term is defined in the Code, means an "interest . . . which secures payment or performance of an obligation."³⁹ If a consignee has no obligation for the payment of money, then no security interest is created for that purpose. It is doubtful that the consignee's duties of safekeeping are obligations which can be said to be secured by the title-retention language of a consignment agreement. This point may be strained, of course, by the consignor who puts too many burdens on the consignee or who allows the consignee to act other than as an agent with respect to the goods.

Nor is there anything in Section 2-326—the one section of the Code specifically dealing with consignment deliveries—which would rule out as a true consignment any delivery intended primarily as a means of finding a market for the goods. The contrary may be said to be the case. Not the slightest suggestion is made that the existence of a true consignment requires that the purpose of the delivery must be to control the price of the delivered goods or some other objective unrelated to placing goods into the stream of commerce. Sale of the goods is clearly contemplated by the section, for "consignment" is used in the context of a delivery to merchants dealing in goods of the kind consigned.

A continuance of the pre-Code agency analysis as the test of a "true consignment" under the Code has the added advantage of giving creditors of the consignee the opportunity to challenge a consignor who fails to police his consignee's agency status. To allow the consignor with a price control objective to escape Article 9's protective measures for creditors simply because the consignment had a non-distribution objective, but not to allow such an escape by the consignor who has used the consignment—and enforced it—to induce a dealer to take merchandise for sale, makes little commercial sense. It is a posture at war with reality. To the consignee's creditors it is immaterial whether the consignment had a substitute-for-security motif or some other business objective. Particularly if there is no filing under Section 2-326(3), what is likely to mislead a creditor is that a consignor does not carry out the terms of an agency and insist that the indicia of that status permeate his relationship with the consignee.

It is on this last point where improvement in the law could profitably be made. Too many of the former cases, litigated when consignments were attempted almost exclusively as a substitute for a sale-security

39. UCC § 1-201(37), quoted in note 2 *supra*.

arrangement, focused on matters which were not likely to come to a third party's attention, and therefore not likely to be known to a prospective creditor. This is one shortcoming of making the consignee's right to return consigned merchandise and not pay for it pivotal to a true consignment.⁴⁰ The right to return is not something which is apparent from any examination of the goods. But tagging the goods, placing them in receptacles marked with the tradename of the consignor, keeping separate books, requiring the consignee to invoice sold items and to bill for them on forms supplied by and bearing the name of the consignor and requiring prior approval by the consignor for a sale on credit—these are factors which will tend to make public knowledge of the agency relation, or at least spread it across the consignee's books and records. Such indicia would therefore tend to safeguard the potential creditor. Creditors should not extend money on the basis of what they observe by cursorily gazing over a mass of merchandise. If the tangible indicia of an agency relation are required, creditors who conduct their own affairs and investigations in good business form are likely to be benefited.⁴¹

ANTITRUST CONSIDERATIONS OF A CONSIGNMENT PLAN

The substance built into the intent test under the Code may also be of importance from the perspective of certain antitrust considerations facing a business planning to utilize consignments in the distribution of

40. With the development of security laws making room for resale of collateral and application of proceeds to business needs, the need for trying consignments as a substitute security agreement for a chattel mortgage or conditional sale subsided. Consequently, the concept of a true consignment, while firmly stated and understood in many cases, never really got to the point of being clearly definable in terms of specifics which would be required. Emphasis varied from case to case and court to court. It is this observer's judgment that courts generally allowed consignors to get away with too much, to impose too many of the burdens of ownership on the consignee—and still call the transaction a consignment. When this occurred, a court was usually giving transcendent importance to the absence of an obligation to pay for the goods or to title language. If courts would make consignors retain the burdens and risks of ownership, and not only extend to a deliverer (called consignee) the privilege of non-payment and of returning the goods, while on the other hand imposing on him the burdens of customer credit, insurance, risk of loss and others, much of the criticism of consignment deliveries would lose its forcefulness. For an early example of a well-drawn consignment see *General Elec. Co. v. Brower*, 221 F. 597 (9th Cir. 1915). For examples of poor results, though the theory of the cases may have been correct, see *In re Sachs*, 21 F.2d 984 (D.C. Md. 1927) (goods to be held by consignee having obligation to insure, to pay all costs of transportation, and others); *McCullum v. Bray-Robinson Clothing Co.*, 24 F.2d 35 (6th Cir. 1928) (consignee paid freight, bore risk of loss); *In re Renfro-Wadenstein*, 42 F.2d 328 (W.D. Wash. 1931) (holding delivery a sale, court nevertheless said that deliverer's guaranty of customer accounts would not indicate a relationship of sale over consignment).

41. Purchasers in the ordinary course of business are not a problem in this area. Their protection is found not only in the common law estoppel theory, but also in UCC § 2-403, discussed in R. Duesenburg & L. King, *SALES AND BULK TRANSFERS UNDER THE U.C.C.*, ch. 10, "Title and the Claims of Third-Party Purchasers" (1966, 1968).

goods. Emerging from recent decisional law concerning price-fixing and the legality of vertical territorial and customer restraints are principles which to a heavy degree are pegged to a determination of whether the underlying transaction by which goods were delivered was a sale or an agency contract. To the extent that the Code intent test depends upon the function of a given transaction rather than on whether an agency in fact was created and carried out, the validity of consignments under applicable antitrust principles would seem to be jeopardized. This follows from the premise underlying the proposition that any consignment intended as a marketing tool is a security agreement. That premise is that a debt exists for which the consignment stands as an attempted security. But from where does the indebtedness arise? The answer must be from a sale of the goods. If this is so, then it follows that the consignor has added to his problem of compliance with Article 9 (which would not be an item of concern if his consignee were not in financial trouble) the increased risk from potential invalidity under antitrust laws.

Of course, some may contend that the factors indicating a sale in consignment clothing may be one thing in the context of determining if the consignment is a security agreement and quite another in assessing the legality of the transaction under antitrust principles. That makes poor law and worse advice, however, when counseling a business client, especially since antitrust condemnation of the kind involved could lead to possible criminal indictment. To inform a businessman that he may be subject to criminal sanctions because a court might transpose the rationale of a case tried under the Code to one of similar facts under the Sherman Act is to give reason for a client to remark with Charles Dickens that "The law is and ass." On the other hand, if agency is the test of a "true consignment" under the Code, then what courts say about a true agency (true consignment) in Code cases will be instructive when assessing the impact of developing antitrust doctrines on distributive programs using consignments.

Antitrust Problems of Consignment Distribution

1. Price Restrictions

The antitrust problems faced in consignment distribution derive from recent decisions challenging price, customer and territorial decision-making and authority where these are retained by a manufacturer or other supplier and exercised over a distributor or dealer. It had long been assumed that manufacturers, assemblers and other suppliers of merchandise could determine the methods used for moving their goods to the marketplace and ultimately to the consumer, and that a part of that distribution method included the ability to establish the price when the

distribution did not involve an intermediate sale and then resale. The method also included the ability to tell a distributor or dealer to whom and where to sell, as long as there was no horizontal carving up going on. *United States v. General Electric*⁴² supported the supplier's price-determination right. That case involved the classic situation of a consignment transaction: title was retained, the goods were segregated, the consignee was obligated to account, he retained the right to return unsold merchandise, and the price of sale was determined by the consignor. Although the case involved patented merchandise, the Supreme Court said that "the owner of an article patented or otherwise is not violating the antitrust law by seeking to dispose of his article directly to the consumer and fixing the price by which his agents transfer the title from him directly to the consumer."⁴³

How long this pronouncement of the mid-twenties will remain valid is difficult to assess. Even the most irresponsible critic of stare decisis would doubtless concede that to topple established doctrines is no easy assignment, the Court's recent record notwithstanding. But much has already been done to weaken the rule of *General Electric*, especially in the last decade. Most important was to carve out of the rule situations involving nonpatented articles, or perhaps more accurately, to restrict the rule to the facts of the case.⁴⁴ That was a major alteration, since the Court in enunciating the rule expressly said that it made no difference whether the goods involved were or were not patented. The case most responsible for this restriction was *Simpson v. Union Oil Company*,⁴⁵ which involved an on-again-off-again price-fixing consignment scheme designed to combat gasoline price wars. Since *Simpson*, other decisions have made short shrift of the fact that a supplier deleted the word "consignment" and called his contract a "supplemental bailment agreement" while merely suggesting the resale price.⁴⁶ The courts also have been unmoved by the fact that the dealers liked their supplier's plan, or that it was used to increase a minority share of the relevant market.⁴⁷

42. 272 U.S. 476 (1926).

43. *Id.* at 488.

44. *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964) ("The patent laws which give a 17-year monopoly on 'making, using or selling the invention' are in pari materia with the antitrust laws and modify them pro tanto. That was the ratio decidendi of the *General Electric* case. . . . We decline the invitation to extend it.") *Id.* at 24.

See also *Lyons v. Westinghouse Corp.*, 235 F. Supp. 526 (S.D.N.Y. 1964) (in observing the quoted portion of *Simpson* above, the court said: "Whether this amounts to overruling *General Electric* or merely limiting it is a matter of semantics. The practical effect is the same, whichever word one uses.") *Id.* at 535.

45. 377 U.S. 13 (1964).

46. *Guidry v. Continental Oil*, 350 F.2d 342 (5th Cir. 1965).

47. *Sun Oil Co. v. Federal Trade Comm'n*, 350 F.2d 624 (7th Cir. 1965) (during the period in question, ten defendant had only up to three dozen stations in the relevant market area, but the scheme was condemned because of the finding that the "commission

Simpson is an extraordinarily important case, for many reasons. For purposes of this discussion, its significance is in the attitude expressed by the Court on consignment contracts. While the contract in *Simpson* was not particularly well-drawn, it was superior to many of the contracts litigated in the context of allegedly deceptive security agreements in the first third of this century. The supplier retained title, paid taxes on the merchandise, and compensated the consignee by paying him a commission. But the consignee assumed most risks of loss, carried the insurance and paid all costs of operation in the manner usual to a party who took title to his inventory. These factors had no effect on the Court, which said that "a consignment, no matter how lawful it might be as a matter of private contract law, must give way before the federal antitrust policy."⁴⁸ This is a very telling point.⁴⁹ Sending goods to a dealer or distributor who may in turn sell them as an agent only at a price determined by the owner may be legal; but it may also be illegal. The circumstances control, and to the Court in *Simpson* the important fact was that the consignment was used as a price-fixing device to implement and cover a vast distribution system.⁵⁰ Small wonder that in November of 1966, the government again challenged the same consignment contract which it had taken on—and lost—in the 1926 encounter with General Electric.⁵¹

2. Territorial and Customer Restrictions

More recently, the sales-agency dichotomy was involved in another Supreme Court antitrust decision,⁵² this time involving the franchise program of one of the nation's largest bicycle manufacturers. At issue was the legality of territorial and customer restrictions found in the dealer and distributor contracts of the Schwinn Company.⁵³ Under these

consignment plan" resulted in horizontal as well as vertical price control). Cf. *CBS Business Equip. Corp. v. Underwood*, 240 F. Supp. 413 (S.D.N.Y. 1964) (holding that simply because article was patented this did not make consignment arrangement per se illegal).

48. 377 U.S. at 17.

49. Ingenious drafting has never been too effective as a shield whenever a court wanted strongly enough to look through the agreement. The concept is therefore not new to antitrust cases, nor to *Simpson* in particular. See *U.S. v. Masonite*, 316 U.S. 265 (1942).

50. By reason of the lease and "consignment" agreement dealers are coercively laced into an arrangement under which their supplier is able to impose noncompetitive prices on thousands of persons whose prices otherwise might be competitive. . . . The present, coercive "consignment" device, if successful against challenge under the antitrust laws, furnishes a wooden formula for administering prices on a vast scale.

377 U.S. at 21-22.

51. *United States v. General Electric Co.*, Civ. No. 66-3118, filed 27 September 1966 in the Southern District of New York.

52. *Arnold, Schwinn & Co. v. United States*, 388 U.S. 365 (1967).

53. Schwinn's distribution system involved several contractual forms. Under the so-called "Schwinn Plan," a distributor took orders from retailers and forwarded them

contracts, the distributors agreed to sell only to franchised dealers in assigned territories. Retail dealers were similarly restricted to specified geographic areas and were authorized to sell only to retail customers, and not to other dealers. Price-fixing was at issue in the trial court, but a finding that there was no violation was not appealed. The commercial purpose of the restrictive covenants was to shore up the interbrand competitive posture of the Schwinn Company outlets, a measure devised because of increased competition to the Schwinn Company from foreign imports and other domestic producers. By assuring Schwinn distributors and dealers freedom from intrabrand competition, it was hoped that Schwinn could more effectively compete with other bicycle manufacturers.⁵⁴

Much can be said, and doubtless will be, about the *Schwinn* decision. The deeper it is probed, the more appears to impeach the reasoning of the majority and to cast shadows of doubt over the meaning of the decision.⁵⁵ As has so often been true in recent years, some of the Court's utterances unnecessary to the decision stir the greatest speculation over the purport of what was written. But for the purposes of this article, it is sufficient to note that the legality of the restrictive covenants was in large measure dependent upon the character of the underlying transaction by which the distributors or dealers came into possession of the goods. If the underlying transaction was a sale, then the Court said unequivocally that restrictions on territory or customers would be illegal per se, whether they resulted from insistence of the manufacturer (vertical) or of the distributors or dealers⁵⁶ (horizontal). If, on the other hand, the manu-

to the manufacturer, which would ship directly but bill the retailer and pay the distributor a commission. A slight variance of this involved drop shipping to the retailer but billing the distributor who forwarded the order. Distributors were also, in some cases, sold to directly. Goods were also sold to retailers through consignments and agency arrangements with distributors. B.F. Goodrich Company, a major outlet, was also sold to directly. But the major technique was through the Schwinn Plan.

54. In instituting the suit, the Department of Justice made clear its view that restricting intrabrand competition is as much in violation of antitrust principles as restrictions on interbrand competition. Whether intrabrand competition should be compelled by the antitrust laws is an issue beyond the scope of this paper, but one well worth pursuing.

55. Perhaps the most forceful criticism of the case was stated in the dissent, which raised the highly relevant inquiry of what effect the majority decision would have in supplanting the independent business in favor of forward integration. In addition, the distinction in results, depending upon whether the underlying transaction was a sale or consignment, predicated on the "ancient rule against restraints on alienation," is not especially persuasive.

56. A combination of distributors to divide territories was censured as per se illegal in *United States v. General Motors*, 384 U.S. 127 (1966). The same occurred in *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), decided the same day as *Schwinn*, in which there appeared the interesting suggestion that per se illegality would not apply to a case of horizontal market splitting among small grocers seeking to stay alive. To

facturer retained "title, risk and dominion"⁵⁷ in the underlying transaction, then the rule of reason would apply, and the restrictions would be adjudged by their competitive effect, so long as they were not part of a scheme involving "unlawful" price-fixing.⁵⁸ As for consignment (agency) arrangements, therefore, the rule of reason test applied to geographic and customer restrictions; but where the goods were delivered under a contract of sale or under a consignment ancillary to and consequently infected with price-fixing, such restrictions would be illegal per se.⁵⁹

Taken together, these cases show evolving in the antitrust area, rules affecting consignment distribution which make it extremely important to know what the legal ingredients of that system are. The *General Electric-Simpson* line instructs that consignments are illegal if they are part of a distribution system where price-fixing is a chief objective. Dicta in the *Schwinn* case echoes *Simpson* to the effect that unlawful price-fixing may invalidate a consignment, just as such a term would make unenforceable and criminal a transaction in which good had been sold. But in the context of territorial and customer restrictions, a distinction was drawn between deliveries on consignment and deliveries under a sale. Risk,

say that horizontal market splitting is per se illegal does not logically allow for the exception of anything, even small grocers.

57. The Court seemed to suggest that retention of all three—risk, title and dominion—was necessary to escape condemnation. *E.g.*, "We conclude that the proper application of § 1 of the Sherman Act to this problem requires differentiation between the situation where the manufacturer parts with title, dominion, or risk with respect to the article, and where he *completely* retains ownership *and* risk of loss." 388 U.S. at 378. Again: "Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with which an article may be traded after the manufacturer has parted with dominion over it." 388 U.S. at 379. And again: "If the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale." 388 U.S. at 379. And finally: "Where the manufacturer retains title, dominion, *and* risk with respect to the product and the position and function of the dealer in question is, in fact, indistinguishable from that of an agent or salesman of the manufacturer, it is only if the impact of the confinement is 'unreasonably' restrictive of competition that a violation of § 1 results from such confinement, unencumbered by culpable price fixing." (Emphasis added). 388 U.S. at 380.

58. By accepting the finding that there was no price-fixing, the Court postured *Schwinn* outside the bounds of illegality exemplified by *United States v. Bausch & Lomb Co.*, 321 U.S. 707 (1944), and many other cases. But it should be noted that the Court opened the door to possible per se illegality arising from efforts to affect resale prices falling "short of unlawful price fixing." 388 U.S. at 373.

59. Once title, risk or dominion is transferred, per se illegality attaches to any agreement to divide territories or customers, under the *Schwinn* rule. The case seems broad enough to cover conduct short of explicit agreement, for the Court said also:

Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his *effort* thereafter to restrict territory or persons to whom the product may be transferred—*whether by explicit agreement or by silent combination or understanding with his vendee*—is a per se violation of § 1 of the Sherman Act.

388 U.S. at 382. (Emphasis supplied).

dominion *and* title in the supplier were emphasized as requirements for a consignment arrangement. If these were retained, then the restraints would have a chance of surviving, depending upon their business objective and their impact on competition.⁶⁰

In some respects, the above synthesis of these cases is an oversimplification. The inference that any delivery coupled with authority to fix price, even where part of a true consignment, is illegal, would probably be too strong a conclusion. Notice that in the *Simpson* case the Court condemned a price-fixing consignment contract which was viewed as part of a "vast distribution system." *Simpson* involved exaggerated facts. Not only were consignments commonly used industry-wide to control prices, but as used by the defendant, it was for price-control purposes only, and to prevent competitive erosion in the context of gasoline wars. There was no other marketing objective; no service feature, no new product being introduced, no test marketing, no use of independents to get established in a market and no apparent management or marketing counsel was given. Indeed, the Court acknowledged that under some circumstances goods delivered under a consignment with the consignor having price-control authority could be proper.⁶¹ When that would be was left for future cases to etch out. Presumably, the simple situation of isolated deliveries by one merchant to another for the latter to sell under terms and at a price set by the former would not come under antitrust censure.⁶² Beyond this, the

60. The rule of reason as applied to the *Schwinn* facts focused on several important points, set forth in the Court's own summary of the case:

Critical in this respect are the facts: (1) that other competitive bicycles are available to distributors and retailers in the marketplace, and there is no showing that they are not in all respects reasonably interchangeable as articles of competitive commerce with the Schwinn product; (2) that Schwinn distributors and retailers handle other brands of bicycles as well as Schwinn's; (3) in the present posture of the case we cannot rule that the vertical restraints are unreasonable because of their intermixture with price fixing; and (4) we cannot disagree with the findings of the trial court that competition made necessary the challenged program; that it was justified by, and went no further than required by, competitive pressures; and that its net effect is to preserve and not to damage competition in the bicycle market. Application of the rule of reason here cannot be confined to intrabrand competition. When we look to the product market as a whole, we cannot conclude that Schwinn's franchise system with respect to products as to which it retains ownership and risk constitutes an unreasonable restraint of trade. This does not, of course, excuse or condone the per se violations which, in substance, consists of the control over the resale of Schwinn's products after Schwinn has parted with ownership thereof. Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict territory or persons to whom the product may be transferred—whether by explicit agreement or by silent combination or understanding with his vendee—is a per se violation of § 1 of the Sherman Act.

388 U.S. at 381.

61. 377 U.S. at 18.

62. "One who sends a rug or a painting or other work of art to a merchant or a gallery for sale at a minimum price can, of course, hold the consignee to the bargain."

permissible scope of price-setting authority is open to debate; but the point is that *Simpson* does not logically render all consignments paralytic simply because in establishing an agency relationship the parties retained price-setting authority in the consignor.

In *Schwinn*, too, consignments involving customer and territorial divisions were per se condemned only where coupled with "unlawful" price-fixing. Otherwise, they were to be judged by their competitive impact. What was meant by "unlawful" in this context is difficult to determine. It might include any situation not covered by the resale price maintenance laws of the various states, or it might be broader in scope—approaching the standard adopted by the Court in *Simpson*. Reading the *Schwinn* lower court decision⁶³ and Supreme Court opinion together, it becomes clear that the Schwinn Company had the business objective of keeping its products out of the hands of discount stores. Thus, even though Schwinn was found not to have set the price at which its consignees and franchisees sold, it would fly in the face of reality to conclude that there was no price motive in its program. If not the objective of price-fixing, Schwinn had at least the objective of price support. By using the adjective "unlawful" in styling all price-fixing consignments as per se illegal, the Court begged the issue of all such challenged cases and did little in the way of enlightening the antitrust bar for assessing the legality of true consignment distribution.

The hedged language of the Court in *Schwinn* leaves open several possibilities. One is that consignment distribution involving price-setting authority in the consignor will fail to get by the Sherman Act⁶⁴ only where the consignment is used as a guise for a sale transaction. This hypothesis is not necessarily inconsistent with what was said in the *Simpson* case, or the cases following therefrom; an examination of the facts of the consignment program in *Simpson* allows placing that fact pattern beyond the boundaries of a true agency relationship.⁶⁵ While the consignor in *Simpson* retained authority to set the price, the allocation of

Id. See also FTC New Release, Adv. Op. Dig. No. 121, April 22, 1967, in which the FTC gave a favorable opinion on the inclusion in a contract between a university press and an academic association of a clause preventing the press from selling a certain book at a price less than that available to association members, where the books were held by the press on consignment.

63. United States v. Arnold, Schwinn & Co., 237 F. Supp. 323 (N.D. Ill. 1965).

64. 15 U.S.C. § 1 (1964).

65. Though the Court agreed that the *Simpson* contract paralleled the consignment contract of *General Electric*, the fact is that there were some differences. In *General Electric*, the consignor assumed losses due to fire, flood and obsolescence, with the consignee being responsible for lost, damaged or missing inventory; in *Simpson* the consignee was not liable only for certain casualties not caused by its negligence. General Electric paid all taxes; the consignor paid only property taxes in *Simpson*. General Electric carried insurance; the consignor did not in *Simpson*. 377 U.S. at 22, 26.

responsibility for the loss of the goods, insurance, credit of the ultimate customer, billing practices and other features were not wholly consistent with a true consignment.

Another hypothesis is that even in a true consignment, the presence of price-fixing authority may result in antitrust condemnation if price-fixing is involved as a prime objective of a "vast distribution system." This, too, is consistent with *Simpson* principles and with the dictum in *Schwinn*. It is also probably more in line with ultimate objectives of the government in cases yet to come; certainly the filing of the latest General Electric complaint would indicate this.⁶⁶

Whichever postulate is considered, it is important that legal analysis of consignments in both the antitrust and commercial areas should be reasonably consistent in order to enable counsel to advise a business client with a minimum of equivocation and indecision. It would be senseless to have a line of cases developing under the Code describing all consignment transactions, irrespective of their "true agency" quality, as security agreements, and simultaneously to have agency elements as the prime test for issues arising under antitrust principles.

As noted previously, the distinction between price-fixing purposes and the objective of getting goods to the marketplace is not valid as *the* distinguishing trait for at least two persuasive reasons. First, the distinction fails to take into account the numerous other motives why a consignment plan may be used; secondly, one or another purpose is rarely the sole explanation for delivering under a consignment. Business plans and transactions are not that simple. If commercial cases view all deliveries "on consignment" as disguised security agreements where movement of the goods to the marketplace is *an* objective, the nature of a true consignment and its place in the law will not be properly developed. And certainly the businessman's right to adequate counsel will not be well-served if the same fact pattern is judged differently depending upon the event precipitating litigation.

Code and Antitrust Oppugnancy

In some respects, consignment cases in the commercial area pull in a direction opposite from developing antitrust concepts. This is most clearly demonstrated by the emphasis on price-fixing authority. In the commercial law context the absence of this prerogative in the consignor indicates that the underlying transaction was a sale rather than a true consignment.⁶⁷ But the retention of price-fixing authority is a matter

66. See note 51 *supra*.

67. *E.g.*, *Miller Rubber Co. v. Citizens Trust & Savings Bank*, 233 F. 488 (9th Cir. 1916); *Union Furniture v. Goetz*, 67 F.2d 201 (7th Cir. 1933).

which under antitrust concepts is inimical to the legality of the agreement. If a consignment is illegal under antitrust principles because it lodges pricing authority in the consignor, its commercial attractiveness is immediately impaired if in the context of non-antitrust commercial litigation the retention of pricing authority is determined to be essential to the establishment of a true consignment.

Some cases indicate that absolute price control in the consignor is necessary for a true consignment, but the prevailing rule does not appear to be that demanding.⁶⁸ In *Schwinn*, the Court did not seem to think that the consignor's right to fix prices was a necessary element of retaining "title, risk, and dominion." And, of course, many of the early consignment cases admitted of the existence of a true consignment even though the consignee had authority to set the price at which goods would be sold, so long as not below a certain minimum. Even when the right to set the price of sale is left solely in the hands of the consignor, it does not necessarily follow that the consignment is afoul of antitrust rules. Future litigation will determine whether retention of pricing authority is decisive to a true consignment. Certainly it will be an important facet of showing an agency; certainly, too, the greater its weight, the more will the results of commercial litigation collide with emerging antitrust concepts.

Another puzzler arises out of the recent *Schwinn* case placed against the backdrop of past litigation contesting the nature of a true consignment. Granting that a true consignment involves an agency relationship, then what risk does the consignor assume if absolute price-setting authority is relinquished in order to minimize the antitrust dangers? If consignment distribution is used as a program (rather than in isolated situations to accommodate special commercial interests which are not likely to be challenged under antitrust principles) then the practical commercial expectation may be that consignees will sell at different prices. This, in turn, raises the possibility that the consignor may face price discrimination charges under the Robinson-Patman Act.⁶⁹ True, criminal sanctions are not involved, and a complaining purchaser will be required to show competitive injury; but at least, in theory, since the consignee is the agent of the consignor in selling, the possibility of a Robinson-Patman violation exists. Research has disclosed no case arising in this context. As a practical point, it may be assumed that the issue is not likely

68. Many cases can be cited holding the contract a true consignment even though the consignee could sell at any price, having only the obligation to remit a certain minimum. *E.g.*, *In re Sachs*, 21 F.2d 984 (D.C. Md. 1927); *In re Eichengreen*, 18 F.2d 101 (D.C. Md. 1927) (court held the transaction a sale and not bailment because of extension of credit terms, but stated that merely because deliverer could fix the price did not of itself mean it was not a consignment).

69. 49 Stat. 1526 (1936).

to come from instances of distribution through retail consignees; the risk is more substantial, however, when consignment is used with wholesalers.

The point is that if the *Schwinn* case gives a shot in the arm to consignment distribution—a highly questionable assumption despite its permission to use consignments for territorial and/or customer allocation—courts should bear in mind the importance of any given opinion beyond the narrow issue presented for decision. Some consignments used to effectuate customer or territorial restraints are almost certain to reach the courts in the context of a bankruptcy dispute involving creditors claiming against the consignor. Too much and too thoughtless an emphasis on pricing authority in the consignor as the badge of a true consignment could have enormous consequences, for draftsmen seeking to avoid a loss to a consignee's creditor by providing for the consignor's authority to set sale price may face the even more painful reality of an antitrust violation. All the factors of each case should be examined to assess whether an agency did in fact exist, even though the agent may have been given some prerogative over setting price. The many cases earlier in the century which allowed a true consignment to be established though the consignee had some authority in deciding the price, as long as not below a prescribed minimum, would appear to accommodate the true consignment concept most favorably, both for antitrust considerations and where a conflict pitting creditor against consignor is in issue.⁷⁰

CODE RULES AND THE CLAIMS OF THIRD PARTIES

Contract Drafting

An obvious counseling point from the foregoing discussion is that attorneys should draft consignments to evidence true agency relationships. Credit terms, terms calling for payment if the goods are not sold or returned by a certain date, and, above all, words such as "sale," "sell to" or reference to the consignee as "purchaser" should absolutely be avoided.⁷¹ It cannot be expected that courts will designate a contract as one of

70. The argument might be made that prohibiting sale at a price below a certain figure is just as much price-fixing, for antitrust purposes, as retaining in the consignor full pricing authority. The argument is not necessarily persuasive, however. The economics of each case should be examined. Suppose the price below which the consignee is not to sell is an invoice price, the same that would have been charged against the distributor or retailer taking goods under a sale. If consignment is used instead of sale, should a price-fixing charge lie simply because the consignee's authority had a floor placed under it? The mark-up in many products is such that effective price competition is possible even though such a minimum is stated in the consignment, and tolerance of this practice in certain situations would seem appropriate. It may well be a reasonable concession under antitrust laws, accommodating valid business reasons, for a consignment to preserve the agreement from attack in bankruptcy or insolvency contexts.

71. *E.g., In re United States Electrical Supply Co.*, 2 F.2d 378 (S.D. Ill. 1924) (consignor called "seller" and consignee called "buyer"; contract held one of sale).

agency—"true consignment"—if the parties themselves deal as though the delivery were pursuant to a sale. Similarly, the transaction should carry adequate indicia of retained ownership and control. The sharp decline of consignment litigation in the mid-thirties aborted the development of clear rules on what criteria establish an agency relation. But the antipathy of courts in antitrust contexts and in commercial litigation suggests that conservative approaches be adopted. A consignor who expects to wield his bargaining strength to impose on a consignee a maximum number of burdens should expect to run the risk of losing his status as consignor, and bear the consequences of having structured a sale/security agreement in the guise of a consignment.

For the reasons just given, a well-drawn consignment will not only provide for retention of title and its passage directly from the consignor to the purchaser, but will retain in the consignor the risks of loss, credit risks of ultimate purchasers, and the costs of insurance, return of the goods and perhaps even of storage. The agreement will provide for shipment to the consignee at the consignor's discretion, with the consignee taking delivery on the consignor's behalf. It will provide that consigned goods are sold for the account of the consignor, that invoicing will be on the letterhead of the consignor, and that monthly billings will come from the consignor's credit department, or be sent by the consignee on the consignor's forms. Proceeds will be held in trust for the consignor and frequent accounting will be required. Wherever practicable, goods will be stored in receptacles supplied by the consignor and bearing his name, with no authority being given the consignee to vary this provision. And finally, of course, the traditional right of the consignee to return for any reason any unsold goods must be provided for without compromise.⁷² Added to these is the important responsibility of the attorney to counsel that these terms be adhered to, and that any deviation by the consignee be immediately cured.

Providing for and performing all or most of these terms is not an easy matter, for either party. An assumption of such burdens would require special circumstances; but that is the situation for which consignments are designed. If a consignment agreement incorporates all or the majority of the above provisions, and if they are adhered to, much will be accomplished to ensure that the courts will find that a true consignment was entered.

Statute of Frauds

On the preceding pages, several important reasons for couching a

72. See text accompanying and following note 19 *supra*. See also *In re Mincow Bag Co.*, 4 U.C.C. Rptg. Serv. 197 (N.Y. Sup. Ct. 1967).

consignment in true agency form have been identified. First, a true consignment comes within Article 2, not Article 9, and allows the parties to shape their own rights and obligations, and to escape certain unalterable rules found in the secured transactions article. A true consignment also, as we have seen, places the parties in a preferable posture under developing antitrust concepts. But there are other points of practical significance which should be noted.

One of these relates to the matter of committing the agreement to writing. Under Article 9,⁷³ a security agreement must be in writing to be enforceable against the debtor or against third parties.⁷⁴ Unlike the statute of frauds of the sales article,⁷⁵ there is no substitute for a writing, unless the collateral is in the possession of the secured party. Obviously, if the deliverer is not a consignee, he is a debtor, but in either case he will be in possession, which means that should the consignment be held to be intended for security, the security interest of the deliverer will have to be in writing to be enforceable. But there is no comparable provision which directs that a true consignment, to be enforceable, need be in writing.

The observation which this statement at once invites is that, as a practical matter, the issue is not likely to arise. Since the goods are in the possession of the consignee, the argument that there is delivery and acceptance in satisfaction of the statute is immediately suggested. But the matter is not quite that simple. The goods may not have been delivered, or may only be partially delivered, at the time a conflict arises concerning performance of an alleged consignment agreement. Or the dispute may arise over the return rights of the consignee or consignor. In either event, the question presented is whether the oral character of the right either to deliver or to return, as the case may be, prevents its proof.

If the transaction is a true consignment, the Article 9 statute of frauds provision will not be troublesome.⁷⁶ But what about Section 2-

73. UCC § 9-203(1) provides, in part, that
[A] security interest is not enforceable against the debtor or third parties unless . . .

(b) the debtor has signed a security agreement which contains a description of the collateral. . . .

74. In *McDonald v. Peoples Auto. Loan & Fin. Corp. of Athens, Inc.*, 4 U.C.C. Rptg. Serv. 49 (Ga. App. 1967), the supplier failed under UCC § 2-326 because of a failure to comply with one of its notoriety clauses, and failed under Article 9 because, *inter alia*, there was no writing evidencing a security agreement signed by the debtor.

75. UCC § 2-201. Exceptions to the signed writing requirement of this section can be found in: subsection (3)(a), the special manufacture rule; subsection (3)(b), in case of an admission in pleadings; subsection (3)(b), in case of payment or acceptance and receipt; and in the case of deals between merchants, in a special rule where the written confirmation of one may operate to satisfy the statute of frauds as to the other (subsection (2)).

76. Cf. *Rottman v. Wallace*, 2 U.C.C. Rptg. Serv. 987 (Pa. C. P. 1962), where the court said that compliance with Article 9's statute of frauds provision is not important in a consignment or in a sale or return.

201? Is that section applicable (assuming the value of goods to be over \$500) either to the consignor's promise, if any, to deliver under the consignment or to the obligation or right of the consignee to return the goods?

Beginning with the consignee's right to return, the answer would on first observation appear to be found in subsection (4) of Section 2-326, which provides that "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 Article 2. Referred to is Section 2-201(1), which states that "a contract for the sale of goods . . . is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made. . . ." ⁷⁷ Notice that both subsection (4) of Section 2-326 and Section 2-201(1) speak in terms of a contract for sale. But, again, a true consignment does not constitute a sale, or even a contract to sell. It is strictly an agency arrangement, by which the consignee is authorized to procure on behalf of the consignor a contract of sale, or whatever else is empowered by the consignment agreement. The only time the delivery on consignment might be a sale is when one of the notoriety provisions of Section 2-326 is not complied with, and the consignment consequently is denominated a "sale or return."⁷⁸ Even then, this consequence is applicable only as to the claims of creditors: "[W]ith respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return."⁷⁹ The section is silent concerning claims between the parties. When one of the notoriety clauses of Section 2-326(3) is complied with, then even this provision is not applicable. It would seem clear, therefore, that a consignment need not be

77. UCC § 2-201 (1) reads in full:

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of \$500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

78. An interesting case, perhaps forecasting the restrictive construction which may be given to UCC § 2-326, is *In re Mincow Bag Co.*, 4 U.C.C. Rptg. Serv. 197 (N.Y. Sup. Ct. 1967). Goods in this case were drop-shipped to the consignee's customers under a consignment agreement which retained title, risk of loss, and the burden of insurance in the consignor. It also provided that the goods could be returned by the consignee, which would have an obligation to pay only if the goods were sold. Since the shipment was not to the consignee, failure to satisfy one of the notoriety provisions of subsection (3) did not impair the ability of the consignor to recover the goods, the court holding that Section 2-326(3) was not applicable to convert the agreement into a sale or return, since the goods were not delivered to the consignee's place of business where it dealt in goods of the kind involved.

79. UCC § 2-326(3), quoted in note 3 *supra*.

in writing for any part of it to be enforceable. Surprising as this reading of Sections 2-326(4) and Section 2-201 may be,⁸⁰ it is what the sections say. Not even the general provision of Article 2 that the Article applies to transactions in goods⁸¹ requires that the statute of frauds be applied to a true consignment, since the specificity of the "contract for sale" language in Section 2-201 should prevail.

Claims of Creditors

I. When §2-326(3) is satisfied in true consignment

Consigned goods are an enticing bounty for eager creditors. How creditors will fair in challenging the consignment will depend directly upon whether the agreement conforms to the tests of true agency and whether the consignor complies with Code requirements.

Subsection (3) of Section 2-326 sets forth three methods of imparting notoriety to a consignment delivery. One is by way of a public filing, as allowed in Article 9. The other two require, respectively, that the consignee be generally known to deal in goods of a third person, or that the consignor comply with a signposting statute of the jurisdiction where the goods are consigned.⁸² Effective signposting is dependent upon the existence of a statute, and not merely the conduct of the parties in placing a marker identifying that the goods belong to another.⁸³ While this act may be helpful in substantiating the general reputation that the consignee is known to deal in non-owned goods, it is not enough to satisfy the signposting test. Since only one jurisdiction remains with a signposting law, and since it is risky business indeed to rely on proving a general

80. Cf. Hawkland, *Consignments Under the Uniform Commercial Code: Sales or Security?*, U.C.C. COORDINATOR, 395, 402 (1963).

81. UCC § 2-102 reads in part: "Unless the context otherwise requires, this Article applies to transactions in goods . . ."

82. UCC § 2-326(3) reads in part as follows:

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).

83. *E.g.*, *In re Levy*, 3 UCC Rptg. Serv. 291 (E.D. Pa. 1965) ("The phrase 'an applicable law' as used in Section 2-326(3) (a) of the Code means a statute."); *In re Downtown Drug Store, Inc.*, 3 UCC Rptg. Serv. 27 (E.D. Pa. 1965) ("The reclamation petitioner contends that the labels on the record racks amounted to compliance with 'an applicable sign law' but . . . there is no 'sign law' in Pennsylvania. That is he says there is no sign statute in Pennsylvania and the sign law referred to in the Code means an applicable statute. Although this limitation seemed to the Referee a bit strained when argued at the hearing, I am now convinced . . . 'an applicable sign law' means a statutory law.").

reputation for dealing in non-owned goods,⁸⁴ the practical step of compliance will most often be that of filing a financing statement as set forth in Article 9.

Whichever course is followed, however, it is clear that Section 2-326 is not then applicable to the consignment transaction. Unequivocally, the subsection provides that it "is not applicable if the person making delivery" satisfied one of the enumerated steps of notoriety. Accordingly, goods in the possession of the true consignee could be recovered by the owner from not only the consignee but also its creditors. This ability to reclaim results from two factors: first is the non-applicability of Section 2-326, and second is that because a true consignment is not a security interest, Article 9 has no application beyond the filing allowed by Section 2-326(3), and the claims of creditors should have no foundation in that article. There is no other provision in the Code for a creditor to turn to.

When §2-326(3) is not satisfied

Though a transaction is a true consignment, creditors of the consignee will have a claim against the goods if one of the notoriety provisions of subsection (3) of Section 2-326 is not met. This is because subsection (3) prescribes that a consignment delivery 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," shall "with respect to claims of creditors of the person conducting the business" be "deemed to be on sale or return." The effect of this provision (which is not applicable where one of the protective steps of the subsection is satisfied) is to subject the goods to the claims of the consignee's creditors, for in subsection (2) it is provided that "goods held on sale or return are subject to such claims while in the buyer's possession."

Subjecting goods held under a true consignment to the claims of the consignee's creditors when none of the notoriety clauses of Section 2-326(3) are met is a shift from results of pre-Code cases. Previously, if the consignment was not a security agreement, the consignor recovered from creditors, including a trustee in bankruptcy. Also, the present Code rule, in some instances, is likely to vary results from what would happen if the consignment were styled a security agreement; that is, if it were determined to have been intended as security. In this event, the con-

84. *E.g.*, *Guardian Discount Co. v. Settles*, 114 Ga. App. 418, 151 S.E.2d 530 (1966) (regarding delivery of used cars by one dealer to another, the court said: "[I]solated sales for one creditor or what the dealer knows of his own business or even what the supplier of the goods knows about the merchandise delivered to such dealer by him is not sufficient to show that the dealer's creditors generally know he is substantially engaged in selling the goods of others.").

signment would be subject to the provisions of Article 9 which read somewhat differently.

“Creditor” is a term encompassing general creditors, secured creditors, lien creditors, and any representative of creditors, including assignees for the benefit of creditors, trustees in bankruptcy, receivers and executors and administrators of insolvent estates.⁸⁵ A consignor who fails to satisfy one of the notoriety provisions of Section 2-326(3) exposes his goods, even though delivered pursuant to a true consignment, to the claims of all of these parties. When the delivery is found to be a security agreement and Article 9 is applicable, and there is no filing, then determining the validity of the consignor’s claim is more complicated. Section 9-301(1) directs that an unperfected security interest is subordinate to judicial lien creditors who become such without knowledge of the security interest and before it is perfected. But this provision yields to Section 9-301(2), when a purchase money security interests is involved. This latter Section cuts off a judicial lien creditor’s claim when the purchase money interest is filed within ten days after the collateral comes into possession of the debtor-consignee, if the competing creditor’s interest arose between the time of the security interest attached and the time of filing.⁸⁶ Since a consignment delivery is usually made in the context of a deferred payment, if the delivery is not a true consignment, it should probably be regarded as a purchase money interest. If not filed within ten days, the creditor-consignor’s interest would be inferior to lien creditors. Regardless of any filing, the consignor’s interest is superior to general unsecured creditors. This difference in result from that reached if the transaction were held to be a true consignment and none of the protective steps under Section 2-326(3) were followed, is probably less important than it first appears. “Lien creditor” is defined in Section 9-301(3) to include a trustee in bankruptcy, assignee for the benefit of creditors, and an equitable receiver. General creditors, therefore, are able to defeat the unperfected-consignment consignor, in most cases, by claiming through their representative.

When no assignment is made or the grounds for appointing an

85. UCC § 1-201(12) :

“Creditor” includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor’s or assignor’s estate.

86. UCC § 9-301 (2) :

(2) If the secured party files with respect to a purchase money security interest before or within ten days after the collateral comes into possession of the debtor, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

equitable receiver are not present, or when a voluntary petition is not filed and for various reasons an involuntary petition is not within grasp, the difference becomes more significant. Under Article 9, the consignee's creditors are required to file a financing statement (which means having to get the signature of the consignee) or acquire a lien by levy, attachment or the like, before the consignor files. If none of these is accomplished, or if the consignor files within the ten days allowed by Section 9-301(2) (assuming the purchase money status to be applied), the consignor will prevail. Whether this is a better position than having the consignment held to be a true consignment subject to the claims of creditors because of non-compliance with a protective step of Section 2-326 depends upon how courts will handle cases of tardy filings. Pre-Code cases under certain chattel mortgage laws become relevant here. These cases, striking down late-filed interests as against creditors acquiring liens after recording by a mortgagee, were litigated under statutes which provided that unrecorded mortgages were invalid against creditors.⁸⁷ This is essentially what Section 2-326(3) provides as to true consignments where none of the protective steps are taken. The point after which a filing by the consignor will be tardy is something future cases will have to determine, but bearing in mind that the Code allows advanced filing, it is not inconceivable that the time to be allowed will be zero days. A consignor would then be worse off under Section 2-326(3) than under Article 9.

III. Impact of Bankruptcy Act

Earlier it was emphasized that filing under Section 2-326(3) or compliance with one of the other protective steps will make the entire subsection inapplicable rather than only cutting off claims of creditors. The importance of this distinction appears when the dispute over a true consignment is presented in a bankruptcy proceeding. If one of the protective steps of Section 2-326(3) is met, the consignor should always prevail. But if none of them are met, then a further uncertainty is injected to complicate the consignor's plight.

The Bankruptcy Act allows a trustee to set aside any "transfer" of a debtor which is fraudulent as against any creditor or which is voidable for any other reason by any creditor.⁸⁸ "Transfer" is defined to include

87. *E.g.*, *In re League Bookbinding Co.*, 339 F.2d 340 (2d Cir. 1964); *Karst v. Gane*, 136 N.Y. 316, 32 N.E. 1073 (1893); *In re Patterson*, 139 F.Supp. 830 (W.D. Mo. 1956).

88. Bankruptcy Act § 70(e), 11 U.S.C. § 110(e)(1) (1964):

A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null

every sale or other disposal of an interest in property and, also "the retention of a security title to property delivered to a debtor. . . ."89 In order to defeat the true consignor the trustee will have to establish that the true consignment was a transfer, as defined in the Act. This burden will be difficult if not impossible to sustain where the true consignment was accompanied by compliance with one of the protective steps of Section 2-326(3) as of the time of delivery of the goods. A true consignment gives rise to a bailment-agency relationship, and not to a retention of title as a security. The consignor retains full ownership and control. However, the consignee does acquire certain powers under a true consignment, including the ability to transfer title to the goods to good faith or ordinary course buyers. Furthermore, as long as the consignor has failed to satisfy one of the notoriety provisions of Section 2-326(3), the consignee also has certain interests which are subject to his creditors' claims. Indeed, by legislative fiat, the true consignment is then converted to a sale or return as to claims of the deliverer's creditors. Conceivably, when there is a tardy filing, the true consignor's retained title might be equated to a security interest and thus qualify as a transfer defined in the Bankruptcy Act. Admittedly, the point is tenuous. What is important is the counseling lesson: the issue can be avoided by making sure that *as of the time of delivery* under a true consignment one of Section 2-326 (3)'s protective steps is satisfied.

The Bankruptcy Act has another provision which is not fully in harmony with Code provisions applicable to deliveries on consignment. In mind is the Act's provision for determining when a transfer is made, which in turn is critical for ascertaining whether a given pattern of events establishes a voidable preference.⁹⁰ Under the Act, a transfer is consummated when it is so far perfected that no judicial lien creditor is thereafter able to acquire rights in property ahead of the rights of the transferee.⁹¹ The point at which this occurs depends upon state law. Assuming that a consignment delivery intended as security would be

and void as against the trustee of such debtor.

89. Bankruptcy Act, 11 U.S.C. § 1(30) (1964).

90. The elements of a preferential transfer are set out in the Bankruptcy Act, 11 U.S.C. § 96(a)(1), (b)(1964). The elements are a transfer of property by the debtor, while insolvent, to a creditor for an antecedent debt within four months of the filing of a petition in bankruptcy, and reason to know or actual knowledge on the part of the creditor of the debtor's insolvency, and a consequently greater per cent of the creditor's debt being satisfied.

91. Bankruptcy Act, 11 U.S.C. § 96(a)(2) (1964) :

For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.

classed as a purchase money interest, the transfer would be made upon the perfection of the interest—unless retroactive effect were available through the ten day provision set forth in Section 9-301(2). But, where the consignment is a true consignment, no time is provided within which the filing called for in Section 2-326(3) (c) must be made. If that filing exists as of the time of delivery, or if one of the other two steps is then satisfied, no problem arises. When there is no such compliance, however, very real difficulties appear.

Suppose that goods are delivered under a true consignment on June 1, and there is no compliance with Section 2-326(3)'s protective steps. Assume further that a financing statement is filed on June 15. On October 10, a petition in bankruptcy is filed by or against the consignee. This petition squarely presents the issue as to whether there has been a preferential transfer. Though more than four months have transpired since the actual delivery, less than four have expired since filing. Section 60(a)(7)(1) of the Bankruptcy Act allows a 21-day grace period for filing when there is no time limit stated in the applicable state law—the situation with regard to Section 2-326. As has been well stated elsewhere, the policy of Article 9 of the Code against secret liens is implemented by a system allowing for advance filings, and the better argument appears to be that the silence of Article 9 as to the time of filing should not be deemed silence at all, but should be read as consistent with the mechanics set up for and the concept of prior filing—indicating that no days are allowed.⁹² If this is the case, and if the reasoning is applicable to the filing called for by Section 2-326, the issue arises as to whether the interest which the consignee received in the goods by virtue of Section 2-326(2) and (3) is sufficient to constitute a transfer, even though the transaction is a true consignment. It could well be a transfer, since a failure at delivery to comply with one of the protective steps would cause the consignment to be deemed a sale or return as to creditors. If it is a transfer, then it should follow that the trustee would be able to get at the consigned goods under the preferential transfer rule (all other elements being present). If the consignment were intended as security, there would be no question as to this result, for, even if Section 9-301(2) were applicable, the filing in the hypothetical was 15 days and not ten after the actual date of delivery.⁹³

92. For an excellent article succinctly stating the clashes between the Code and the Bankruptcy Act, see King, *Voidable Preferences and the Uniform Commercial Code*, 52 CORN. L. Q. 925 (1967).

93. The hypothetical intentionally uses a case of a filing tardy by 15 days. Suppose the situation of a true consignment when none of the notoriety provisions of Section 2-326(3) are met, and the filing is then made less than ten days after delivery. Should the filing have retroactive effect? The answer depends upon whether the purchase money filing provision of the Code, Section 9-301(2), is applicable to the true con-

One additional instance of probable conflict between consignors and competing creditors is worthy of mention. This is the situation of an existing creditor with a perfected inventory security interest covering after-acquired property. Section 9-312 sets forth certain rules of priority, one subsection⁹⁴ providing that a supplier of inventory takes priority over a prior perfected interest in inventory if the subsequent security interest is a purchase money interest and certain formal requisites are satisfied. These latter include giving notice to the prior secured creditor and perfecting the subsequent interest before debtor receives possession of the newly supplied inventory. Since a true consignment does not create a security interest, because no debt obligation arises from the transaction, the consignor should not be required to give such notice. But prior inventory creditors could defeat the consignor's interest when the consignor failed to comply with one of the protective steps of Section 2-326(3).

An interesting question arises as to whether a true consignor should give notice to existing inventory creditors as a protective measure because of the imprecision of case law in identifying a true consignment. One might argue that by giving such a notice, the consignor exhibits an intent that the consignment is security. In view of the uncertainty of the case law, this result would appear to be an unfair penalty for a consignor who chooses to take such a precautionary step. In any event, if notice is given, it should clearly state that it is intended as a precaution, and is not to be construed as indicating an intent that the consignment be considered a

signment case, as distinguished from the situation of a consignment intended as security; in the latter case it would certainly be applicable.

It has been stated that "A true consignment . . . in which there is no obligation to pay for the goods unless they are sold, is not subject to this article except as provided in UCC § 2-326." *In re Mincow Bag Co.*, 4 U.C.C. Rptg. Serv. 197 (N.Y.S.Ct. 1967) (a case in which there was no compliance with the notoriety provisions of Section 2-326(3); but the court held this to be immaterial, since the goods were not delivered to the consignee's place of business, but rather to customers of the consignee, so that neither Section 2-326 nor any provision of Article 9 was held applicable, and the consignor was able to recover from the trustee). If the only provisions of Article 9 applicable to the true consignment are the mechanical rules of filing in Section 9-401 and 9-402, then the retroactive provision of the purchase money interest would not apply. This would seem to be the correct answer, but there is some doubt about it. *See King, supra* note 92, at 934.

94. UCC § 9-312(3) :

(3) A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if

- (a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and
- (b) any secured party whose security interest is known to the holder of the purchase money security interest or who prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest.

security agreement.

In whatever context a claim is asserted by competing creditors, whether in bankruptcy or outside of bankruptcy, whether by a judicial lien creditor or by a creditor with a prior perfected security interest in inventory, the preceding discussion underscores the critical importance of a well-drawn consignment agreement and of taking advantage of the filing or other protective steps referred to in Section 2-326(3). Falling short of the mark on either of these two points portends only potential problems for the consignor should an occasion arise in which his right of reclamation is contested. Amendments to both the Code, especially Section 2-326, and the Bankruptcy Act are in order to synthesize the interaction of these two statutes. But the present failure of these two laws to take into account their mutual involvement in given disputes is no excuse for the parties not to take the appropriate precautions; the proper precautions would preclude the circumstances in which creditors could use either or both laws as a weapon to frustrate the right of repossession which a consignor may have intended to preserve.