

The UCC's Consignment Rule Needs an Exception for Consumers*

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*"[A]ll of these [certain UCC rules for merchants] rest on the vital need for distinguishing merchants from housewives"*¹

I. INTRODUCTION

It is classic learning that Article 9 of the Uniform Commercial Code requires creditors claiming nonpossessory interests in goods to file a financing statement so that third parties will have notice of the interests and will not rely on the debtor's possession, that is, will not be misled by the debtor's ostensible ownership of the goods. The development of credit practices since the drafting and adoption of the Code render that rationale invalid when the third party is a creditor, as opposed to a buyer. That is not to suggest that we do away with the Code's filing scheme, but rather that we look, in the creditor context, to a different rationale for support of that scheme.

That support lies not in a need to protect third-party creditors but in a need to inhibit practices that commercial law deems fraudulent. Third-party creditors usually find the unrecorded interests or are not hurt by ignoring them. Modern credit practices and realities make it impossible for the creditor to rely solely on a filing search and on the debtor's possession of goods. The many exceptions to the filing rules and the important buyer-protection rules render that kind of credit investigation unsound, and modern credit practices support the view that it is obsolete.²

One case does exist, however, in which the sophisticated credit search does not find the unrecorded interest: that in which the debtor and a creditor deliberately hide that interest. In order to catch these fraudulent concealments and inhibit them, we indorse the Code's filing rules. Those rules, of course, cast a wide net and sometimes ensnare an innocent creditor, but the cost of separating the innocent creditor that fails to file through inadvertence or ignorance from the fraudulent creditor that intentionally hides his interest is heavy, and the Code wisely favors rules that apply to creditors, both innocent and fraudulent.

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1. REPORT OF THE NEW YORK L. REV'N COMM'N FOR 1954, HEARINGS ON THE UNIFORM COMMERCIAL CODE 108 (1954) (statement of K. Llewellyn).

2. See *infra* part V.

At first blush this substitution of a fraud-in-law rationale for the classic ostensible-ownership rationale does not appear to make much difference. Both justifications support the view that creditors must file. The substitution does make a difference, however, in the anomolous situation in which a consumer finances a merchant's inventory. That situation arises when a consumer consigns personal, family, or household goods to a merchant for sale; and just as it is anomolous to think of a consumer as financing the merchant's inventory, so it is to apply inventory financing rules to the consumer. The plain language of the Code, however, does apply them to the consumer-consignor.³

In a narrow context, this Article shows that by substituting the antifraud rationale for the classic rationale, courts will be able to fashion a principled exception to that plain language and to the anomalous result it dictates. In the broader context, this Article suggests the need to test application of Code filing rules in other situations, especially those involving consumers, when those rules may satisfy the old rationale but not the new.

II. THE CONSIGNMENT DEVICE

The consignment is a legal device whereby an entruster (the consignor) delivers goods to an trustee (the consignee) for sale and both parties agree that the consignor shall retain title and the consignee will be a "mere" or "naked" agent-bailee. The consignment device has a checkered history in commercial law. The notion is at once simple, seductive, and commercially baleful. The merchants who invented it argued that, unless authorized by the owner of the goods, the bailee could convey no interest to a buyer or creditor because the bailee had no interest of his own to convey and no authority to convey the owner's interest. In the heyday of the factor courts accepted that argument,⁴ but with the demise of factoring observers of commercial law denied the consignor his ownership claim and damned him as a secret lienor and pariah of commercial law.⁵ In accordance with this latter view, so many courts fashioned exceptions to the consignment definition that it became useless as a security device. They fashioned these exceptions with rules of estoppel, apparent authority, and ostensible ownership⁶ and with distinctions between false and true consignments. Courts distinguished false consignments, in which the parties created a disguised security agreement, from true consignments, in which the parties had no intention of using the consignment device to secure payment of the purchase price.⁷

3. See *infra* part VII.

4. See, e.g., *Ludvigh v. American Woolen Co.*, 231 U.S. 522 (1913).

5. See generally I G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* 73-75 (1965).

6. E.g., *Kearby v. Western States Sec. Co.*, 31 Ariz. 104, 250 P. 766 (1926); *Zendman v. Henry Winston, Inc.*, 305 N.Y. 180, 111 N.E.2d 871 (1953). See generally L. VOLD, *HANDBOOK OF THE LAW OF SALES*, §§ 61, 78 (2d ed. 1959).

7. E.g., *Liebowitz v. Voiello*, 107 F.2d 914 (2d Cir. 1939); *In re Leflys*, 229 F. 695 (7th Cir. 1916). *Contra* *General Elec. Co. v. Martin*, 99 W. Va. 519, 130 S.E. 299 (1925).

The parties' intent always has been difficult for courts to divine,⁸ and section 2-326 of the Uniform Commercial Code obviates this difficulty by rendering the distinction between true and false consignments unimportant in the financing context.⁹ With respect to third-party creditors, the section destroys the effect of the true consignment unless the consignor complies with the filing provisions of the Secured Transactions Article¹⁰ or shows that under local practices his retained interest is generally known.¹¹ The section renders the interest of the consignor-owner subordinate¹² to the claims¹³ of the bailee's creditors and thus virtually renders a true consignment the equivalent of an unperfected security interest. For example, an automobile manufacturer that consigns automobiles to a dealer and fails to comply with the perfection rules of Article 9 will be unable to prevent the secured creditors and lien creditors of the dealer¹⁴ from satisfying their claims out of the consigned

8. "It is neither easy nor practical to say where a consignment ends and a sale begins." Liebowitz v. Voiello, 107 F.2d 914, 916-17 (2d Cir. 1939).

9. See *infra* note 40.

10. The consignor may, however, use the terms "consignor" and "consignee" rather than "creditor" and "debtor". See U.C.C. § 9-408 (1978).

11. Subsection 2-326(3) provides:

Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum". However, this subsection is not applicable if the person making delivery

- (a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or
- (b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or
- (c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

Id. § 2-326(3).

12. The statute does not use the word "subordinate," but says that the goods are "subject to" the claims of creditors. *Id.* § 2-326(2). The "subject to" language should not be read to mean that the rights of the consignor are relative to the rights of the creditors. *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960), read the words "subject to" in that fashion, but *Kravitz* concerned construction of § 2-702(3), which renders the right of a seller to reclaim "subject to" the "rights" of lien creditors. U.C.C. § 2-702(3) (1978). The *Kravitz* court concluded that the "subject to" language did not command the court to subordinate the seller's right to that of the lien creditor, but commanded the court to compare the two rights to determine whether law outside the Code rendered the one or the other superior. See also *Federal's, Inc. v. Matsushita Elec. Corp.* (*In re Federal's, Inc.*), 553 F.2d 509, 511-12 (6th Cir. 1977) (reading "subject to" in the same way). No court has adopted that view of the "subject to" language in § 2-326. *But see* J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 886 (2d ed. 1980).

13. Under § 2-326(2) the rights of the consignor are not subject to the rights of the consignee's creditors. It is the goods that are subject to the claims of the consignee's creditors. General creditors have no claim to the consignee's goods until those creditors become lien creditors or secured parties. Comment 2 of § 2-326, however, asserts that § 2-326(3), the imputation rule which prevents the consignor from using distinctions between sales and agency to escape the rule of § 2-326(2), resolves doubts "in favor of the general creditors" of the consignee. U.C.C. § 2-326 comment 2, sentence 1 (1978). That comment is inconsistent with the language of § 2-326(2) and appears to be overbroad. See *infra* note 14. *But cf.* *General Elec. Co. v. Pettingell Supply Co.*, 347 Mass. 631, 199 N.E.2d 326 (1964) (holding that an assignee for the benefit of creditors defeats a consignor who fails to comply with § 2-326(3)).

14. Subsection 2-326(2) renders the consigned goods subject to the "claims" of the consignee's creditors, *i.e.*, subject to the rights of creditors having an interest in the goods. U.C.C. § 2-326(2) (1978). The only persons who possibly can have that interest under the Code's general scheme would be secured creditors (both perfected and unperfected) and lien creditors. Unsecured creditors that have no lien have no "claim" to the goods. *But cf.* U.C.C. § 2-326 comment 2, sentence 1 (1978).

inventory.¹⁵ It is immaterial, moreover, whether the consignment is a true consignment or a disguised security interest. If it is a true consignment, section 2-326 requires filing unless local practice renders the consignment a matter of public knowledge. If the consignment is a disguised security interest, Article 9 mandates filing.

Recently courts have declined to apply section 2-326 to several cases in which the consignors were consumers.¹⁶ The courts appear to have reached the correct results, but their justifications are unconvincing and have done mischief to valuable commercial principles.¹⁷

This Article concludes that it is time to define explicitly an exception to the consignment rule in favor of entrusters who also are consumers. This new consumer exception is supported by both the rationale for the Code's anti-consignment rule in section 2-326 and the Code's general rules of construction. This Article argues first that the entrustment rules of the Code and the common law, though originally bottomed on ostensible-ownership theory, are now valid only as antifraud provisions that serve intuitive notions of judicial efficiency; second, that an exception under section 2-326 for consumer entrusters does not offend the antifraud presumptions of the rule; and third, that courts, therefore, should adopt and freely acknowledge such a consumer exception to section 2-326.

III. THE CONSIGNMENT RULE IN PERSPECTIVE

The problem of consignments is one part of a grand contest in commercial law: the dispute between true owners on the one hand and purchasers on the other. In the consignment setting the true owner is the consignor and the purchaser¹⁸ is a creditor of the consignee retailer. Thus, if a wholesale distributor of books consigns a shipment to a retail bookstore, the dispute will arise when the bookstore's creditor—for example, the store's trustee in bankruptcy—and the distributor both claim the books.

15. An arena of dispute remains, of course, between the consignor on the one hand and buyers from the dealer on the other. U.C.C. §§ 2-403(2), 9-301(1)(c), 9-306(2), and 9-307(1) (1978), deal with that arena. If the consignment section of Article 2 leaves any breath in the life of consignments, those provisions of Articles 2 and 9 smother it completely. See *infra* part III.

16. This Article's use of the term "consumer" rather than the term "nonmerchant" reflects the judgment that the exception advocated here should benefit only those persons who are not engaging in mercantile activity and are disposing of their personal, family, or household effects. The law should recognize that such sales are essentially noncommercial. Cf. U.C.C. § 9-307(2) (1978) (generally differentiating such sales by a consumer from sales by a merchant). I intentionally have eschewed the term "nonmerchant," though that term might well fit. Cf. U.C.C. § 2-104(1) (1978) (defining "merchant"). Unfortunately, cases do exist that refuse to apply the term "merchant" to activity that is mercantile in nature. See, e.g., *Cook Grains, Inc. v. Fallis*, 239 Ark. 962, 395 S.W.2d 555 (1965); *Coast Laundry, Inc. v. Lincoln City*, 9 Or. App. 521, 497 P.2d 1224 (1972). Thus, the term "consumer" avoids any implication that mercantile activity might fall within the exception.

17. See *infra* text accompanying notes 89-129.

18. Subsection 1-201(32) defines "purchase" to include taking an interest in goods by, among other methods, voluntary pledge or lien. U.C.C. § 1-201(32) (1978). Significantly, however, the anticonsignor rule of § 2-326(2) benefits creditors whether or not they rise to the level of purchasers. For example, the trustee in bankruptcy, who is not a purchaser, benefits from § 2-326(2). *Id.* § 2-326(2).

Rules apart from those of consignment govern disputes between the wholesaler and retail buyers. A brief look at these buyer-protection rules, which run parallel to the rule proposed by this Article, will put the consignment rule in perspective.

Generally, an innocent buyer of books from the retailer will prevail over the wholesaler. Such a buyer, because it takes from a retailer, is one in ordinary course¹⁹ and will defeat the entrusting wholesaler under the rules of section 2-403(2).²⁰ Whether the consignment is true or false, the Code consistently protects these buyers. Because of this consistent treatment, the difficulty in distinguishing true from false consignments is obviated under the Code in the context of buyer protection.

First is the true consignment. Here the wholesaler is a principal and the retailer its agent. Second is the false consignment, in which the wholesaler is a disguised creditor and the retailer its debtor. Article 2 protects the buyer in the former,²¹ and Article 9 in the latter.²² Thus, certain buyers—those that are buyers in ordinary course—will defeat a wholesaler that entrusts books to a retailer in either a true or a false consignment. Generally, these buyers are consumers. Persons buying in bulk or not in the ordinary course of business do not always qualify for protection against the distributor. Sometimes they do qualify for protection,²³ but the point is that innocent, good faith consumer-buyers always do, whether protected under Article 2 or Article 9.

The bookstore's creditors receive similar protection under the Code. If the consignment is false, the wholesaler itself is a creditor, and the rules of Article 9 govern.²⁴ Article 9 will protect the bookstore's other creditors unless the wholesaler has complied with the perfection rules of the Article. If it fails to comply, it is an unperfected secured party.²⁵ Its retention of title under the consignment theory will be of no avail.²⁶ An unperfected secured party will lose to other secured parties that perfect²⁷ and to creditors that obtain a lien.²⁸

In true consignment cases the result in the dispute between the wholesaler and the bookstore's creditors is largely the same as that in false con-

19. See U.C.C. § 1-201(9) (1978) (defining "buyer in ordinary course of business").

20. Subsection (2) of § 2-403 provides: "Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business." *Id.* § 2-403(2).

21. See *id.*

22. See *id.* § 9-301(1)(c) (buyer who gives value and takes delivery without knowledge of wholesaler's unperfected security interest defeats claim of wholesaler); *id.* § 9-306(2) (buyer protected against wholesaler's perfected security interest if the wholesaler authorizes sales); *id.* § 9-307(1) (buyer in ordinary course protected against wholesaler's perfected security interest).

23. See *id.* §§ 9-301(1)(c), -306(2).

24. See *id.* § 9-102(1), (2).

25. See *id.* § 9-303(1).

26. See *id.* § 9-202 (provisions of Article 9 apply whether title is in the secured party or the debtor).

27. See, e.g., *American Nat'l Bank v. Tina Marie Homes, Inc.*, 28 Colo. App. 477, 476 P.2d 573 (1970); *American Nat'l Bank v. Christensen*, 28 Colo. App. 501, 476 P.2d 281 (1970); see generally U.C.C. § 9-312(5) (1978).

28. See U.C.C. § 9-301(1)(b) (1978).

signment cases. The governing provision, however, is not in Article 9, which applies when the consignment is false and the wholesaler is a disguised creditor, but section 2-326, which applies to true consignments in which the distributor is a principal and the bookstore its agent. The resolution of the dispute between the true consignor and the agent's creditors requires a close look at section 2-326.

IV. THE APPLICATION OF SECTION 2-326

Analysis of section 2-326 begins with the rule that Article 9 governs a "consignment intended as security"²⁹—the false consignment. In false consignment cases, in which the book distributor and the retailer stand in a creditor-debtor relationship, section 2-326 does not apply. It applies only in cases of true consignment, in which the distributor is the principal and the retailer an agent. The true consignment is a bailment—the broadest term that describes delivery of goods to a party who will not become their owner. Leases, storage arrangements, and service contracts under which an owner delivers goods to a party for repair or fabrication are also typical bailments, but these bailments differ from a true consignment because they do not entail delivery for the ultimate purpose of sale.³⁰

Section 2-326 describes this sale aspect of the true consignment in language that is problematical. First, the provision eschews the term "consignment"³¹ altogether for the term "sale or return." A sale or return occurs if delivered goods "may be returned by the *buyer*" and if they are "delivered primarily for *resale*."³² A true consignment, of course, is not a sale between the book distributor and the bookstore. A sale "consists in the passing of title from the seller to the buyer for a price."³³ In the true consignment, however, the distributor specifically reserves title in itself. A "buyer," moreover, is "a person who buys or contracts to buy goods."³⁴ Under the consignment device the true consignee-bookstore is not a buyer, but an agent holding the goods of the distributor.

Despite the problematical language of subsection 2-326(1), section 2-326 does apply to the true consignment's principal-agent relationship. Subsection 2-326(3) provides that when "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 . . . the goods are deemed to be on sale or return."³⁵ Thus, subsection

29. *Id.* § 9-102(2).

30. *See, e.g.,* *Medomak Canning Co. v. William Underwood Co. (In re Medomak Canning Co.)*, 25 U.C.C. Rep. Serv. (Callaghan) 437 (Bankr. D. Me. 1977), *aff'd without opinion*, 588 F.2d 818 (1st Cir. 1978).

31. *Cf.* U.C.C. § 1-201(37) (1978) (specifically referring to "consignments" and to § 2-326 as containing "the provisions on consignment sales"). Note that in § 2-326(3) the provision uses the term in quotation marks. *Id.* § 2-326(3).

32. *Id.* § 2-326(1)(b) (emphasis added).

33. *Id.* § 2-106(1).

34. *Id.* § 2-103(1)(a).

35. For the language of § 2-326(3), see *supra* note 11.

2-326(3) creates an imputation rule:³⁶ it estops the parties, whatever their intent or characterization of the transaction, from disputing the claim of the bookstore's creditor by arguing that the books belong to the distributor.³⁷ Section 2-326 operates on the assumption that notwithstanding any agency and bailment arguments, the parties intended a sale and the bookstore holds an interest in the books.³⁸

This imputation of a sale avoids in one stroke the complex inquiry that attended common-law attempts to distinguish true from false consignments.³⁹ In short, both true and false consignments fall within section 2-326. Article 9, however, preempts the application of the section in false consignment cases. That preemption may not make much difference, however, because Article 9 treatment of false consignments is virtually identical to section 2-326 treatment of true ones.⁴⁰ The significant point for this discussion is that true consignments do fall within the rule of section 2-326.

That rule, furthermore, basically disfavors the book distributor in its contest with the bookstore's creditors. Subsection (2) establishes the general

36. The comment reports that the whole section "presupposes that a contract for sale is contemplated by the parties." U.C.C. § 2-326 comment 1, paragraph 3 (1978).

37. *General Elec. Co. v. Pettingell Supply Co.*, 347 Mass. 631, 633-34, 199 N.E.2d 326, 328 (1964), is the leading case for the view that it is unnecessary to show a sale by the wholesaler to the distributor to apply § 2-326. *See also Bischoff v. Thomasson*, 400 So. 2d 359, 365 (Ala. 1981).

38. Pursuant to the general policies of this Act which require good faith not only between the parties to the sales contract, but as against interested third parties, subsection (3) resolves all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer. As against such creditors words such as "on consignment" or "on memorandum", with or without words of reservation of title in the seller, are disregarded when the buyer has a place of business at which he deals in goods of the kind involved.

U.C.C. § 2-326 comment 2 (1978). *Accord In re A & T Kwik-N-Handi, Inc.*, 13 U.C.C. Rep. Serv. (Callaghan) 779 (Bankr. M.D. Ga. 1973); *In re Novak*, 7 U.C.C. Rep. Serv. (Callaghan) 196 (Md. Cir. Ct. 1969); *American Nat'l Bank v. Tina Marie Homes, Inc.*, 28 Colo. App. 477, 476 P.2d 573 (1970). *General Elec. Co. v. Pettingell Supply Co.*, 347 Mass. 631, 199 N.E.2d 326 (1964). U.C.C. § 1-201(37) (1978), says that all true consignments are "subject to" section 2-326, and some commentators interpret that language to mean that a true consignor must comply with one of the notice requirements in § 2-326(3). *See* I P. COOGAN, W. HOGAN, D. VAGTS & J. MCDONNELL, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 4A-72 (1982). In *Manger v. Davis*, 619 P.2d 687, 693 (Utah 1980), however, the court concluded that if the consignment was true and the consignee did not maintain a place of business, neither Article 2 nor Article 9 applied. *See infra* note 128 and accompanying text.

39. *See, e.g., General Elec. Co. v. Martin*, 99 W. Va. 519, 523, 130 S.E. 299, 300-01 (1925), in which the court lists several considerations in making the determination. The process at common law in distinguishing the true consignment (a bailment) from the false consignment (a security agreement) was similar to the difficult procedure courts now follow when trying to distinguish a true lease (a bailment) from a disguised installment sales contract (a security agreement). *See, e.g., In re Peacock*, 30 U.C.C. Rep. Serv. (Callaghan) 1671 (Bankr. N.D. Tex. 1980).

Some courts look to the intent of the parties to determine whether the consignment falls into Article 2 or Article 9. *See Nauman v. First Nat'l Bank*, 50 Mich. App. 41, 212 N.W.2d 760 (1973); *Clark Oil & Ref. Co. v. Liddicoat*, 65 Wis. 2d 612, 223 N.W.2d 530 (1974); *Columbia Int'l Corp. v. Kempler*, 46 Wis. 2d 550, 175 N.W.2d 465 (1970). The last two cases make a facile distinction. In both cases the Supreme Court of Wisconsin argued that Article 2 applies if the parties are using the consignment to maintain the resale price. Parties, however, may use resale price maintenance and a credit sale in the same transaction.

40. For the purpose of determining the validity of the parties' arrangement, two differences exist in Code treatment of true consignments under Article 2 and false ones under Article 9. The first difference arises when the consignor files a financing statement but does not obtain a written consignment agreement signed by the consignee. If that consignment is false, Article 9 applies, and the failure to have a signed security agreement renders the consignor an unsecured creditor. *See* U.C.C. § 9-203(1) (1978). If the consignment is true, however, the failure to have a signed agreement is of no moment under the Code unless the Article 2 statute of frauds

rule that "goods held on sale or return are subject to [claims of the buyer's creditors] while in the buyer's possession."⁴¹ Subsection (3) follows subsection (2) with the imputation rule discussed above and then exempts from that rule true consignments in which the book distributor complies with Article 9, observes a state sign law that permits the distributor to give notice by posting a sign, or demonstrates that the bookstore's creditors generally knew that the store dealt in consigned goods.⁴² Again, the language of subsection (3) reflects inartful drafting. The universal understanding appears to be that a consignor, such as the book distributor, that complies with one of the three notice rules of subsection (3) will escape the pro-creditor rule of subsection (2).⁴³ The language of subsection (3), however, exempts the notifying book distributor from the imputation rule of subsection (3), not the pro-creditor rule of subsection (2).⁴⁴ Courts, quite properly, have not read section 2-326 in that fashion, but have indicated that a book distributor which fits into the exceptions in subsection (3) not only escapes the imputation rule of subsection (3) but also escapes the pro-creditor rule of subsection (2).⁴⁵ The chief precept of the consignment section, then, is quite plain: a distributor that fails to provide public notice of its interest will lose to the bookstore's creditors that have

governs. *Id.* § 2-201. The second difference arises when the consignor attempts to escape the creditor's claim via exceptions (a) and (b) of § 2-326(3). Those exceptions are available only to true consignors.

These instances have arisen infrequently. I can find no reported cases of the first. *But cf. In re De'Cor Wallcovering Studios, Inc.*, 8 U.C.C. Rep. Serv. (Callaghan) 59 (Bankr. E.D. Wis. 1970) (in which the consignor had neither a signed agreement nor a filing). Cases concerning exceptions (a) and (b) are equally rare. I find none in which a court has applied exception (a) and only one in which exception (b) was applied. That one case, *In re Griffin*, 1 U.C.C. Rep. Serv. (Callaghan) 492 (W.D. Pa. 1960), appears, moreover, to misapply the rule. *See infra* text accompanying notes 111-14. It is significant, moreover, that when the sponsoring agencies amended the official version of the Code in 1972, they added § 9-114, which parallels the purchase money rule of § 9-312(3) for secured parties, and thus evidenced a desire to treat priorities in the same fashion for both true consignors and secured parties. *See* U.C.C. § 9-114 app. I, Reasons for 1972 Adoption of New Section.

The distinction between true and false consignments also may have a bearing on priority rules not governed by § 9-114 and on the rights of the consignor in the event of the consignee's default. With the exception of § 9-114, presumably the Article 9 priority and default rules do not apply to true consignments. While the validity questions often have been the subject of litigation, the priority and default questions have not.

41. U.C.C. § 2-326(2) (1978).

42. *Id.* § 2-326(3).

43. *See* R. HENSON, HANDBOOK ON SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 49-50 (2d ed. 1979); J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 884 (2d ed. 1980); Hawkland, *Consignment Selling Under the Uniform Code*, 67 COM. L.J. 146, 147 (1962). *See also In re Levi*, 3 U.C.C. Rep. Serv. (Callaghan) 291, 292 (Bankr. E.D. Pa. 1965).

44. Subsection 2-326(2) begins, of course, with the words "except as provided in subsection (3)." U.C.C. § 2-326(2) (1978). That phrase, however, does not correct the problem. It says simply that the pro-creditor rule of § 2-326(2) applies except as provided in 2-326(3). Subsection 2-326(3) says its imputation rule will not operate against the notifying book distributor. It does not say that the pro-creditor rule will not operate against the notifying distributor, and book distributors may exist whom courts, without using the imputation rule, find to be delivering books on a sale or return basis. While the syntax of the section supports that reading, common sense does not.

45. *See, e.g., In re Griffin*, 1 U.C.C. Rep. Serv. (Callaghan) 492 (Bankr. W.D. Pa. 1960). Most cases hold that the consignor did not satisfy the exception, but they indicate that had he satisfied it the pro-creditor rule of § 2-326(2) would not apply. *See, e.g., Grady v. Gennett (In re Pro-Med Co.)*, 31 U.C.C. Rep. Serv. (Callaghan) 83, 84 (Bankr. S.D. Fla. 1981); *Buchanan v. Mobile Home Guar. Corp.*, 14 U.C.C. Rep. Serv. (Callaghan) 1150 (Bankr. E.D. Tenn. 1974); *In re Webb*, 13 U.C.C. Rep. Serv. (Callaghan) 394 (Bankr. S.D. Tex. 1973); *American Nat'l Bank v. Quad Constr., Inc.*, 31 Colo. App. 373, 377-78, 504 P.2d 1113, 1116 (1972).

claims. In a word, the provision is a pro-creditor rule that penalizes the book distributor even when it is a principal in a true consignment rather than a disguised creditor trying to hide its interest.

V. THE FALLACY OF THE OSTENSIBLE-OWNERSHIP RATIONALE

The traditional rationale for the pro-creditor rule of section 2-326 rests on the notion that even the true consignment is a commercially harmful device that misleads the bookstore's creditors into extending credit on the strength of the store's ostensible ownership of the consigned books. That notion does not fare well, however, in light of current creditor practices. The only advantage of the pro-creditor rule today is its inhibition of fraudulent practices at little cost.

Comment 2 to section 2-326 articulates the traditional justification for the pro-creditor rule of subsections 2-326(2) and 2-326(3): "The purpose of the exception [in favor of the distributor that gives notice] is merely to limit the effect of the present subsection itself . . . to cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation."⁴⁶ Courts generally accept this ostensible-ownership rationale.⁴⁷

At one time creditors may have relied on their debtor's stock in trade, but modern commercial lenders, beginning with the advent of open-account selling and inventory financing, stopped extending credit based on a debtor's ostensible ownership of merchandise. Today creditors either investigate that appearance or do not rely on it at all.

Non-real estate, commercial creditors generally fall into two classes: sellers that permit buyers to defer payment and institutional lenders that make discrete loans against inventory and accounts or general working capital loans. Credit sellers usually deliver on open account with a short (thirty to ninety day) term, but sometimes finance longer term credit on, for example, expensive equipment. Institutional lenders frequently lend for terms of years or on a revolving basis under which borrowers draw on a line of credit and repay loans as cash flow requires or permits. Both types of creditor make their credit judgments on a number of considerations, including the debtor's credit history, its financial statements, and, in some cases, searches for filings in favor of other creditors.

Although some inventory lenders and some working capital lenders are concerned about inventory levels, those lenders are too sophisticated to rely solely on inspections of the debtor's shelves or showroom and on filings.

46. U.C.C. § 2-326 comment 2, last sentence (1978) (emphasis added).

47. See, e.g., *American Nat'l Bank v. Quad Constr., Inc.*, 31 Colo. App. 373, 504 P.2d 1113 (1972); *Guardian Discount Co. v. Settles*, 114 Ga. App. 418, 151 S.E.2d 530 (1966); *Columbia Int'l Corp. v. Kempler*, 46 Wis. 2d 550, 175 N.W.2d 465 (1970). In *G.B.S. Meat Ind. Pty. Ltd. v. Kress-Dobkin Co.*, 27 U.C.C. Rep. Serv. (Callaghan) 388 (W.D. Pa. 1979), the court refused to apply § 2-326(2) in the creditor's favor because the creditor had actual knowledge of the consignment.

Instead, they require periodic reports by independent auditors or conduct their own inventory checks. In either event they keep track of inventory by certifying existing levels against supplier invoices and delivery records and often monitor sales records and verify such information with standard auditing techniques.⁴⁸ In many cases, of course, a lender with a security interest in inventory will not monitor the inventory at all but will rely on the general financial integrity of the borrower or on guaranties from third parties.⁴⁹ The unsecured seller on credit—the typical open-account seller—does not rely on inventory levels and usually does not see its retail buyer's place of business. Rather, the buyer's credit history and credit rating, which the seller does see, determine the availability of credit.

Modern credit practices thus have outgrown the ostensible-ownership doctrine. Creditors actually do not rely⁵⁰ on their debtors' ostensible ownership of inventory;⁵¹ instead they verify that ownership with more than filing searches, rely on other collateral, or depend on the general creditworthiness of the borrower or a guarantor.⁵²

Besides section 2-326, two other pro-creditor Code rules appear at first glance to be supported by the ostensible-ownership rationale: the bulk sales provisions in Article 6 and the *Twyne* rule⁵³ of subsection 2-402(2).⁵⁴ Both

48. Inventory lenders, furthermore, must be wary of the effect of the buyer-protection rules of §§ 9-306(2) and 9-307(1). An inventory lender cannot rely for long on inventory audits because the buyer-protection rules permit most buyers out of inventory to take free of the lender's security interest. U.C.C. §§ 9-306(2), -307(1) (1978). Finally, inventory lenders must deal with § 2-402(2), which explicitly sanctions the practice of leaving sold goods with the seller for a reasonable length of time after sale. For a recent case that clearly demonstrates the folly of creditor reliance on a merchant's naked possession of inventory, see *Wilson v. M & W Gear, Inc.*, ___ Ill. App. 3d ___, 442 N.E.2d 670 (1982).

49. It would be a mistake to underestimate the extent to which lenders with security interests take those interests only as a precaution. Because large corporations usually borrow on the strength of their financial statements and profit history, the security interest in inventory is often a small consideration. Sometimes the lender will not bother to take such an interest. In small, closely-held-company borrowing the lender most often looks to the credit standing of individuals who will guarantee the debt and not to specific property of the borrower. Inventory financing, of course, is substantial, and many lenders, especially floorplanners, rely heavily on the debtor's inventory. Those lenders, however, take sophisticated measures to determine outstanding claims to the debtor's inventory and are not fooled by a consignment arrangement.

50. That reliance does arise on the part of buyers, however, and the Code protects buyers in that reliance. See U.C.C. §§ 2-403(2), 9-301(1)(c), 9-306(2), 9-307(1) (1978). See *supra* in part III the discussion of these rules as they relate to consignments.

51. I am mindful that the credit industry is not above crying "wolf" in the face of arguments such as those advanced in the text. See, for example, the argument of the National Commercial Finance Conference, Inc. in *Chrysler Corp. v. Adamatic, Inc.*, 59 Wis. 2d 219, 240, 208 N.W.2d 97, 107 (1973). I have commented elsewhere on the mischief of that argument. See Dolan, *The Uniform Commercial Code and the Concept of Possession in the Marketing and Financing of Goods*, 56 TEX. L. REV. 1147 (1978). Ironically, as that article points out, creditors rely more on their debtor's nonpossession than on his possession, because a nonpossessing debtor usually cannot defeat the creditor's interest by selling to a buyer.

52. This view—that the ostensible-ownership doctrine no longer can justify subordinating the claims of one creditor to those of another—has broad implications. Some might take it to mean, for example, that purchase-money sellers should prevail over lenders with security interests in after-acquired property. It is true that the ostensible-ownership doctrine is not persuasive in that context, as Judge Ainsworth's dissenting opinion in *Stowers v. Mahon*, 526 F.2d 1238 (5th Cir. 1976), makes clear. Nonetheless, I do not wish to challenge *Stowers* and similar cases. The integrity and efficiency of a notice-filing system, concerns different from those of the ostensible-ownership doctrine, provide the support for the *Stowers* rule. For a discussion of these questions in yet a third setting, see Dolan, *A Good Faith Purchase Study: True Owners and the Warehouse Lien*, 18 HOUS. L. REV. 267, 287-89 (1981).

53. See *Twyne's Case*, 76 Eng. Rep. 809 (Star Ch. 1601).

54. U.C.C. § 2-402(2) (1978). See *infra* text accompanying notes 57-73.

rules find no firmer support in the ostensible-ownership rationale than does the consignment rule, but both do make sense as antifraud provisions. They thus give us the key to rationalizing the pro-creditor consignment rule of section 2-326, which favors the bookstore's creditor over the bookstore's distributor.

Article 6 stipulates that the bulk buyer must notify the seller's creditors of the impending bulk sale.⁵⁵ If it fails to do so, transfer of the merchandise to the buyer will be "ineffective against any creditor of the transferor."⁵⁶ Similarly, under subsection 2-402(2)⁵⁷ and common-law cases,⁵⁸ if a buyer leaves goods in the possession of the seller beyond a commercially reasonable period of time, a creditor of the seller may treat the sale as void.⁵⁹

Both rules may appear to concern ostensible ownership, but both clearly do not. Comment 2 to section 6-101 explains that the "central purpose [of the bulk sales law] is to deal with two common forms of commercial fraud."⁶⁰ The effect of the *Twyne* line of cases was to impute fraud⁶¹ when the intent required by the Statute of Elizabeth⁶² rule against fraudulent conveyances⁶³ was missing. The *Twyne* rule applied irrespective of reliance by any creditor and forced the buyer to explain its unusual commercial conduct.

In *Twyne* Pierce, who owed money to *C*, conveyed property to *Twyne*, who left Pierce in possession.⁶⁴ Nothing in that possession misled *C*, however, because Pierce incurred the debt to *C* before the conveyance.⁶⁵ In *Sturtevant v. Ballard*,⁶⁶ a leading American case applying the *Twyne* rule, Mecker obtained judgment against Holt, who was also indebted to third parties and conveyed assets to those third parties while remaining in possession of the goods.⁶⁷ Thus, in *Sturtevant* the ostensible ownership did not mislead Mecker. In both *Twyne*⁶⁸ and *Sturtevant*,⁶⁹ however, the courts found

55. U.C.C. § 6-104(1) (1978).

56. *Id.*

57. *Id.* § 2-402(2).

58. See *infra* text accompanying notes 64-73.

59. Subsection 2-402(2) does not codify the *Twyne* rule. It sanctions the rule in states where courts have adopted *Twyne*.

60. U.C.C. § 6-101 comment 2 (1978) (emphasis added). Comment 2 further provides:

(a) The merchant, owing debts, who sells out his stock in trade to a friend for less than it is worth, pays his creditors less than he owes them, and hopes to come back into the business through the back door some time in the future.

(b) The merchant, owing debts, who sells out his stock in trade to anyone for any price, pockets the proceeds, and disappears leaving his creditors unpaid.

Id.

61. See *infra* text accompanying notes 64-73.

62. 13 Eliz. ch. 5 (1570).

63. The Statute of Elizabeth, the model for most modern fraudulent conveyance statutes, rendered the fraudulent conveyance of "none effect." 13 Eliz. ch. 5 (1570). The *Twyne* rule recognized by § 2-402(2) gives the creditors of the fraudulent transferor the right to levy on the goods. See U.C.C. § 2-402(2) (1978).

64. 76 Eng. Rep. 809, 810 (Star Ch. 1601).

65. *Id.*

66. 9 Johns. 337 (N.Y. 1812).

67. *Id.* at 338.

68. 76 Eng. Rep. 809, 823 (Star Ch. 1601).

69. 9 Johns. 337, 344 (N.Y. 1812).

the seller's retention of the goods to be indicative of a fraud on the creditor seeking to attach those goods.

In *Benedict v. Ratner*,⁷⁰ a case similar to *Twyne*, the trustee in bankruptcy challenged the practice of the bankrupt, who had conveyed accounts to a lender but continued to collect them and hold the proceeds. In short, the trustee was challenging an early instance of revolving, account-receivable financing in which the lender lets the debtor handle the accounts until the lender feels insecure, in which event the lender notifies the account debtors and collects the accounts itself. The *Benedict* Court found the practice fraudulent,⁷¹ and Justice Brandeis explained that the antifraud rule he invoked "rests not upon seeming ownership because of possession retained, but upon lack of ownership because of dominion reserved. It does not raise a presumption of fraud. It imputes fraud conclusively"⁷² It is significant that Justice Brandeis considered the ostensible-ownership doctrine itself to be grounded in fraud and not to be based exclusively on a desire to protect the innocent creditor that relies on appearances of ownership.⁷³

In short, the bulk sales rules of Article 6 and the seller-retention rule of subsection 2-402(2), both of which protect the creditors of persons holding the property of others, are aimed at penalizing commercial practices that smack of fraud. These rules, moreover, have three important similarities.

First, both antifraud rules provide an easy avenue of escape for the honest participant. Under Article 6 the honest bulk buyer presumably will give notice and thereby preclude any claim that it conspired with the bulk seller to defraud the seller's creditors. In a fraudulent retention case the honest buyer that leaves identified goods with the seller can explain the reasonableness of its conduct and thereby escape the fraud presumption of subsection 2-402(2).⁷⁴

Second, both rules reflect the value judgment that the cost of showing fraudulent intent is sufficiently great that it outweighs the cost of possible unfairness that the rules may visit on an unsuspecting buyer. Under both rules an innocent buyer that harbors no fraudulent intent may suffer loss. Even though the buyer in bulk may be unaware of the notice provisions of Article 6 or the inclusion of its purchase within the definition of a bulk sale, the statute will operate against it. Similarly, the innocent and unsuspecting buyer that leaves goods with the seller and cannot demonstrate a commercially reason-

70. 268 U.S. 353 (1925).

71. *Id.* at 360.

72. *Id.* at 363.

73. The Code, of course, rejects the *Benedict* rule, which posed obstacles to some forms of lending. See U.C.C. § 9-205 comments 1-4 (1978).

74. Unfortunately, courts sometimes overlook § 2-402(2), even when it clearly merits discussion. Few modern cases exist from which we can elicit any consistent pattern. The discussion in the text, then, positing an exception for consumers under § 2-402(2), is more theoretical than real. For two cases in which that theory would make sense, see *Rex Fin. Corp. v. Mobile Am. Corp.*, 119 Ariz. 176, 580 P.2d 8 (1978) (a consumer case), and *Sherrock v. Commercial Credit Corp.*, 290 A.2d 648 (Del. 1972) (a nonconsumer case). See generally Dolan, *The U.C.C. Framework: Conveyancing Principles and Property Interests*, 59 B.U.L. REV. 811, 838-42 (1979).

able explanation for its conduct will lose to the seller's creditors. In both instances it is difficult to show fraudulent intent. The adoption of these rules reflects the value judgment that commercial gains achieved by presuming fraud outweigh the commercial losses inflicted by those presumptions.

Last, both commercial fraud rules do not affect consumers. Few, if any, consumer purchases would rise to the level of a bulk sale, which by definition must comprise a major part of the seller's inventory and must occur outside the ordinary course of business.⁷⁵ By the same token, the fraudulent retention rule of section 2-402(2) does not easily operate against consumers. As the court in *Patten v. Smith*⁷⁶ observed, the practice of buying goods and leaving them with the seller "is an extraordinary exception to the usual course of dealing, and requires a satisfactory explanation."⁷⁷ Any buyer who can provide that explanation should have no difficulty with the rule—only the lack of "some sufficient motive"⁷⁸ triggers the fraud presumption.⁷⁹ Thus, a consumer who leaves goods with the seller to have accessories installed, surprise a family member, or wait for a kitchen to be painted will satisfy the rule easily.

Briefly, then, the bulk sales and fraudulent retention rules reflect similar patterns: first, they provide an easy avenue of escape for the honest participant; second, they presuppose that presuming fraud is more efficient than requiring a creditor to show fraudulent intent and reliance; and third, they tend not to operate against consumers. Casting the consignment rule of section 2-326 as an antifraud rule rather than an ostensible-ownership rule⁸⁰ effects the same pattern.

VI. SECTION 2-326 AS AN ANTIFRAUD RULE

It may appear illogical to say on the one hand that commercial law should penalize the secret lienor because secret liens are fraudulent, while arguing on the other that the retailer's creditors do not rely on the retailer's possession

75. See U.C.C. § 6-102 (1978).

76. 5 Conn. 196 (1824).

77. *Id.* at 199.

78. *Sturtevant v. Ballard*, 9 Johns. 337, 339 (N.Y. 1812).

79. *But see Sherrock v. Commercial Credit Corp.*, 290 A.2d 648 (Del. 1972) (The buyer, itself an automobile dealer, purchased two vehicles and, without explanation, left them with a financially ailing seller, which also was a dealer. The court, however, did not apply the rule of § 2-402(2).) For criticism of *Sherrock*, see Dolan, *supra* note 74, at 838-39. In *Weidinger Chevrolet, Inc. v. Universal C.I.T. Credit Corp.*, 501 F.2d 459 (8th Cir.), *cert. denied*, 419 U.S. 1033 (1974), a buyer of used cars from a dealer left them on the dealer's lot. The court did not mention § 2-402(2), but found that the arrangement was a consignment under § 2-326 and, therefore, the dealer's creditor defeated the buyer. *Id.* at 465.

80. The meaning of this Article is not that possession of goods has no bearing on commercial law. As the previous discussion of the buyer-in-ordinary-course rules suggests, possession by a merchant seller may have significant consequences for buyers. Similarly, the retailer's nonpossession may be significant. In *re Mincow Bag Co.*, 29 A.D.2d 400, 288 N.Y.S.2d 364, 366 (1968), *aff'd*, 24 N.Y.2d 776, 248 N.E.2d 26, 300 N.Y.S.2d 115 (1969), for example, holds that the consignment section does not apply in favor of the creditors of a bankrupt against a consignor that delivered to the bankrupt's customers rather than the bankrupt. Possession does have commercial significance, but it should not justify reliance by a creditor of the party in possession. See generally Dolan, *The Uniform Commercial Code and the Concept of Possession in the Marketing and Financing of Goods*, 56 TEX. L. REV. 1147 (1978).

and, therefore, are not misled or harmed by the secretive conduct. Why, one might ask, was Justice Brandeis concerned not with “seeming ownership” but with “lack of ownership”? Why is commercial law unwilling to let the parties determine ownership in the bulk sales, *Twyne*, and consignment situations as long as no one relies on the false appearances created by their arrangements?

The answers to these questions lie in various concerns of the law, other than creditor reliance, present in its treatment of ostensible ownership. In *Benedict* Justice Brandeis was concerned about the law’s integrity and the ability of commercial parties to distort the concept of ownership so that an apparent nonowner becomes an owner.⁸¹ In *Twyne* the Court of Star Chamber was concerned that buyers not be permitted to engage in unusual transactions—those that the *Patten* Court later described as “extraordinary exception[s] to the usual course of dealing”⁸²—without explanation for that conduct. Courts that invoke the *Twyne* rule want to know why a buyer would pay for merchandise and yet walk away without it. If the buyer has an explanation, it does not suffer the consequences of the *Twyne* rule; but if it does not, the law is suspicious and assumes the buyer is engaged in fraudulent conduct even if no one is misled. The presumption, of course, is that the *Twyne* buyer is not a buyer but a lender that is trying to prevent the seller’s creditors from attaching the seller’s goods.

In consignment cases commercial law should be concerned that an unperfected creditor, the book distributor in the false consignment setting, might fare better than other unperfected creditors. The integrity of the filing system rests on the assumption that creditors not in possession must file. Exceptions to the filing rules do exist,⁸³ but in those cases the law assumes that the benefits derived from the exception exceed the costs to the system.⁸⁴ No reason exists to permit the book distributor to fare better, even if no one has been misled. Some consignors in a true consignment, however, are not creditors at all but principals; and the consignment rule catches them. Experience teaches, however, that avoiding the complex inquiry of distinguishing true from false consignments by requiring the principal to give notice is far better than wrestling with the distinction.

If the creditor-reliance rationale for the consignment section’s pro-creditor rule fails to justify the rule, the only justification lies in antifraud considerations. Book distributors that secretly consign books to retailers do not deserve protection and may not assert their title against the retailer’s creditors. Only two explanations exist for such conduct: the distributor is either a

81. 268 U.S. 353, 363 (1925).

82. 5 Conn. 196, 199 (1824).

83. See U.C.C. § 9-302(1) (1978).

84. The *Twyne* rule (and perhaps the *Benedict* rule) also may reflect the early common-law dissatisfaction with the notion that possession and ownership can be separated. “Lord Kenyon said that he lamented that it was ever decided that the possession and apparent ownership of personal property might be in one person, and the title in another . . .” *Sturtevant v. Ballard*, 9 Johns. 337, 343 (N.Y. 1812).

true consignor or a disguised inventory lender. Commercial law should protect the distributor in the former case but not in the latter. Because the cost of distinguishing the two cases is great, the law presumes the latter and invokes the pro-creditor rule of section 2-326 at the risk of catching a few innocent, true consignment distributors that are unaware of the rule.

This analysis of section 2-326 and the discussion of the bulk sales and *Twyne* rules is similar in other respects. The consignment section provides an easy escape for the honest merchant that complies with section 2-326(3) just as the other rules provide an easy escape for honest parties. The consignment section, moreover, is like the bulk sales and *Twyne* rules: all favor the creditors of the third party (the bulk seller, the seller retaining possession, or the bookstore consignee) over the true owner because the burden of distinguishing true consignors from false consignors, like the burden of proving fraudulent intent in the bulk sales and *Twyne* settings, is too great for the law to bear. Finally, and most importantly for the thesis of this Article, the consignment section is similar to the bulk sales and *Twyne* rules because it is not directed at consumers.

The law may have difficulty discerning the true consignor book distributor, but not distinguishing the true consignor consumer. Although book distributors often may extend credit, consumers do not.⁸⁵ Consumers who deliver books to a bookstore, antiques to a kitchen shop, or mobile homes to a dealer are always true consignors. To invoke the consignment rule of section 2-326 against consumers would not serve the purpose of the rule. Similarly, to invoke the rule against consumers would violate the Code's command that the "Act shall be liberally construed and applied to promote its underlying purposes and policies."⁸⁶

VII. JUDICIAL APPROACHES TO THE CONSUMER-CONSIGNOR ISSUE

Courts generally recognize the commercial good sense of the consumer exception, but have not articulated a satisfactory rationale in its support. Failure to articulate a satisfactory rationale results in two harmful consequences. First, cases that favor the consumer usually distort the section and thus make bad consignment law;⁸⁷ and second, at least one court would rule against the consumer.⁸⁸

85. Of course, an individual may extend credit to an enterprise because of some underlying relationship. Such an interested person, if he can claim to be a consumer, is easy to identify, and it is difficult to conceive of his extending credit by delivering an article of merchandise. If an individual consigns a significant portion of an enterprise's inventory, he cannot claim to be a consumer. The thesis of this Article, then, substitutes the problem of distinguishing consumers from nonconsumers for that of distinguishing true and false consignments, assumes that the former distinction is far easier to apply, and recognizes the vital need expressed by Professor Llewellyn in the epigraph. See *supra* p. 21. See also *supra* note 16.

86. See U.C.C. § 1-102(1) (1978). "[T]he proper construction of the Act requires that its interpretation and application be limited to its reason." *Id.* comment 1, sentence 3. See *infra* text accompanying notes 137-39.

87. See *infra* text accompanying notes 89-129.

88. See *infra* text accompanying notes 129-35.

In *Allgeier v. Campisi*⁸⁹ the “individual owner of an automobile”⁹⁰ delivered it to an automobile dealer “for the purpose of having said dealer secure offers . . . and to sell the same upon approval of an offer by the individual . . . [said] dealer to receive a commission of a set sum”⁹¹ The transaction is a classic true consignment. The individual is the principal and the dealer is the agent. The bailment clearly falls within the “deemed to be on sale or return” rule of subsection 2-326(3).⁹² As subsection 2-326(3) requires, the goods were “delivered to a person for sale and such person [maintained] a place of business at which he [dealt] in goods of the kind involved, under a name other than the name of the person making delivery.”⁹³ Any other reading of subsection 2-326(3) would permit the book wholesaler to deliver large inventories to the bookstore and escape the reach of the rule. Other readings, then, conflict with the purpose of the consignment rule and well-reasoned case law to the contrary.⁹⁴ The *Allgeier* court held, however, in a short, one-paragraph opinion that section 2-326 did not apply.⁹⁵

The opinion’s reference to the “individual owner” may be fairly read as implying a consumer exception to the consignment provision. Subsequent cases have read *Allgeier* that way,⁹⁶ and the case should not stand as authority for the proposition that a similar delivery by a nonconsumer would escape the rule of section 2-326. The opinion’s weakness is its failure to articulate any rationale for the consumer exception. The opinion also neglects to state clearly that the court did not apply the section because the consignor was a consumer. *Allgeier*, then, fails to admit that it is framing a consumer exception and to provide a rationale for that exception.

In *Founders Investment Corp. v. Fegett*⁹⁷ a Kentucky court avoided the consumer-exception issue by misconstruing the statute. The *Fegett* court subscribed to the individual-commercial distinction of *Allgeier*, but misconstrued the “deemed to be on sale or return” language of the section. In *Fegett* a dealer sold a mobile home to Mr. Griffee, an elderly man who could neither read nor write and whose wife subsequently became ill and was hospitalized.⁹⁸ In the hope that he ultimately could avoid both his lot rental cost and his monthly loan payments, Mr. Griffee vacated his home, moved it to the dealer’s lot, and instructed the dealer to solicit orders.⁹⁹

89. 117 Ga. App. 105, 159 S.E.2d 458 (1968).

90. *Id.*, 159 S.E.2d at 459.

91. *Id.*

92. U.C.C. § 2-326(3) (1978).

93. *Id.*

94. *See, e.g.*, *Buchanan v. Mobile Home Guar. Corp. (In re International Mobile Homes of Johnson City, Inc.)*, 14 U.C.C. Rep. Serv. (Callaghan) 1150 (Bankr. E.D. Tenn. 1974); *In re Bro Cliff, Inc.*, 8 U.C.C. Rep. Serv. (Callaghan) 242 (Bankr. W.D. Mich. 1970); *Blowers v. First Nat’l Bank*, 45 Ala. App. 485, 232 So. 2d 666 (1970).

95. 117 Ga. App. 105, 159 S.E.2d 458 (1968).

96. *See Founders Inv. Corp. v. Fegett*, 23 U.C.C. Rep. Serv. (Callaghan) 903 (Ky. Ct. App. 1978); *Bischoff v. Thomasson*, 400 So. 2d 359, 367 (Ala. 1981).

97. 23 U.C.C. Rep. Serv. (Callaghan) 903 (Ky. Ct. App. 1978).

98. *Id.* at 904.

99. *Id.* at 905.

Thus Mr. Griffee fell into the trap of the consignment rule's imputation section,¹⁰⁰ a trap that, under the thesis of this Article, results from a desire to avoid the necessity of finding fraudulent intent. Clearly, the rule should not apply to Mr. Griffee, and the court so held.¹⁰¹ Unfortunately, the *Fegett* court was not satisfied with the unarticulated rule of *Allgeier* and observed that it found "nothing in [the] record which would support an inference that the agreement [between Griffee and the dealer] constituted a basis for a sale or return."¹⁰² That assertion, of course, was incorrect. The court went even further: "At most, we glean that Griffee intended to create a limited bailment or sales agency in [the dealer]."¹⁰³ Such limited bailments and sales agencies, however, are the type of consignment conduct to which the drafters addressed section 2-326. All true consignments are limited bailments. Their hallmark is the principal-agent relationship. In short, the *Fegett* court used characteristics of a true consignment to support its position that no consignment was present. If *Fegett* serves as precedent in merchant entrustment cases, section 2-326 will have no room in which to operate.

In *Newhall v. Haines*¹⁰⁴ the court took a different tack. In *Newhall* Bobby Ruth Snider opened a boutique, in which she sold gourmet foods and other similar items. Six months later she attempted to augment sales by adding antiques and other "collectibles" to her inventory.¹⁰⁵ She obtained the former lines of merchandise from commercial suppliers and the antiques and collectibles from local residents who responded to her newspaper advertisements soliciting such wares. When the business failed, the trustee in bankruptcy claimed that the antiques and collectibles were consigned merchandise subject to the rule of section 2-326.¹⁰⁶ Clearly, they were governed by section 2-326 unless it does not operate against consumer-consigned merchandise. The court, however, ruled that the imputation rule of subsection 2-326(3) would not apply in this context.¹⁰⁷ That rule covers consignments of merchandise to a person who, according to the subsection, "maintains a place of business at which he deals in goods of the kind involved."¹⁰⁸ The bankrupt, the *Newhall* court held, took consigned goods at a place of business where she dealt in gourmet foods and like effects—a kind of goods different from the antiques and collectibles consigned. Thus, the court refused to apply the subsection.¹⁰⁹

100. Some courts have demonstrated a marked reluctance to invoke the imputation rule, even in the commercial entrustment setting. See *W.N. Provenzano, Inc., v. Monahan & Co.*, 13 Bankr. 248 (Bankr. D. Mass. 1981); *In re Boersma*, 10 U.C.C. Rep. Serv. (Callaghan) 1312 (Bankr. W.D. Mich. 1971). For two other cases that protect commercial consignors and implicitly reject the view of § 2-326 advanced by this Article, see *Clark Oil & Ref. Co. v. Liddicoat*, 65 Wis. 2d 612, 223 N.W.2d 530 (1974); *Columbia Int'l Corp. v. Kempler*, 46 Wis. 2d 550, 175 N.W.2d 465 (1970).

101. 23 U.C.C. Rep. Serv. (Callaghan) 903, 905-06 (Ky. Ct. App. 1978).

102. *Id.* at 905.

103. *Id.*

104. 31 U.C.C. Rep. Serv. (Callaghan) 1291 (D. Mont. 1981).

105. *Id.* at 1292-93.

106. *Id.* at 1292.

107. *Id.* at 1297-98.

108. U.C.C. § 2-326(3) (1978).

109. 31 U.C.C. Rep. Serv. (Callaghan) 1291, 1296 (D. Mont. 1981).

Newhall, then, is an extraordinary misreading of subsection 2-326(3). The bankrupt in *Newhall* sold antiques and collectibles at her shop. She clearly was a person described in the statutory language to which the court referred. She maintained a place of business where she dealt in goods of the kind entrusted—a place where she sold antiques and collectibles. The *Newhall* opinion would add to subsection 2-326(3) the requirement that the consignee deal in nonconsigned goods similar to the kind consigned.¹¹⁰ Thus, if *Newhall* is good precedent, section 2-326 would catch a wholesaler that consigns part of a bookstore's inventory but not one that consigns all of a store's inventory or all of the book inventory of a store that also sells tobacco and candy. *Newhall*, then, would carve a gaping hole in the imputation rule of subsection 2-326(3) through which many commercial consignors undoubtedly would escape.

*In re Griffen*¹¹¹ is a case with similar facts. In *Griffen* individuals delivered used furniture to a person who formerly was in the business of cleaning rugs and furniture.¹¹² The dealer posted a sign describing the business as one selling new and used furniture, but no new furniture was present on the premises.¹¹³ The court reasoned that, because people generally would know that this business was selling the goods of others, exception (b) to the imputation rule of subsection 2-326(3) should apply.¹¹⁴ The *Griffen* court's characterization of the facts is not credible. If a store's sign proclaims that it sells new and used furniture, but no new furniture is present on the premises, Father Brown or Jane Marple might recognize that the store owner has obtained his used furniture on consignment rather than in trade, but most observers would conclude that the proprietor was puffing a little and was just a dealer in second-hand furniture. Surely exception (b) is not satisfied by the unwarranted conclusion to which the *Griffen* court jumped. *Griffin* is simply another case in a line of decisions that refuses to apply the imputation rule against consumers, but cannot find a valid rationale for a consumer exception.¹¹⁵

*Allsop v. Ernst*¹¹⁶ protected the consumer-consignor with yet another theory that will do damage to the operation of section 2-326 if courts adopt it in the commercial-consignment setting. In *Allsop* a widow entrusted her deceased husband's diamond ring to her son, who, in turn, entrusted it to

110. In *General Elec. Co. v. Pettingell Supply Co.*, 347 Mass. 631, 199 N.E.2d 326 (1964), the consignor argued that the dealer sold consigned merchandise only under the name of the consignor, General Electric. The court held, however, that § 2-326 applied because the dealer sold other electrical, hardware merchandise. *Id.* at 634, 199 N.E.2d at 329. In *Newhall* no suggestion was made that the retailer sold antiques and collectibles under any name other than her own. *Pettingell* correctly suggests that a court should look to the character of the dealer's nonconsigned inventory only when the dealer is selling consigned goods under the name of the consignor.

111. 1 U.C.C. Rep. Serv. (Callaghan) 492 (Bankr. W.D. Pa. 1960).

112. *Id.* at 492-93.

113. *Id.* at 494-95.

114. *Id.* at 494.

115. See *supra* text accompanying notes 89-111.

116. 20 Bankr. 627 (Bankr. S.D. Ohio 1982).

Roudebush, "a person who knew about jewelry (including diamonds) and had experience buying and selling jewelry and diamonds."¹¹⁷ The parties stipulated that Roudebush had a business card designating his business as "Stephen's Jewelry Company," but neither the stipulation nor the court's opinion indicate whether the card bore any address. The stipulation did indicate, however, that while Roudebush held the ring he rented a place of business for two months, received and made telephone calls from a jeweler's office, and engaged in some sales talk in a cocktail lounge where he was well known.¹¹⁸

The parties stipulated that the entrustment was pursuant to an oral understanding that Roudebush would solicit offers for the ring and convey them to the owner.¹¹⁹ The oral understanding further provided that Roudebush himself could not "purchase" the ring.¹²⁰ Thus, the stipulation established a delivery that would fall within the imputation rule if Roudebush maintained a place of business where he dealt in goods of the kind, as subsection 2-326(3) purports to require.

Relying heavily on the ostensible-ownership rationale, the court found the "place of business" evidence insufficient.¹²¹ Because the rule rests on ostensible-ownership considerations, the court intimates, the gravamen of the consignor's conduct is that of misleading creditors. "[U]ltimate liability should rest with the party who has 'permitted' the consignment to take place without notice to the creditors, i.e., upon the party who was in a position to prevent the loss to both parties."¹²² Two facts in particular moved the court: first, prior to the time Roudebush rented an office of his own the owner had requested him to return the ring;¹²³ and second, the record did not show "that the diamond was 'inventoried' at the place of business."¹²⁴ Thus, the court applied agency principles and ruled against the claim of Roudebush's trustee in bankruptcy.¹²⁵

Several reported cases¹²⁶ indicate that owners frequently sell jewelry under similar entrustment arrangements to agents who are "transient"—the word used by the *Allsop* court to describe Roudebush.¹²⁷ These marketing efforts clearly resemble the old factor method of selling, in which consignments were an important commercial device. Undoubtedly, the "place of

117. *Id.* at 628.

118. *Id.* at 628-29.

119. *Id.* at 629.

120. *Id.*

121. *Id.* at 630.

122. *Id.* at 630-31.

123. *Id.* at 631.

124. *Id.*

125. *Id.* at 630-31.

126. *See, e.g.*, *Kimberly & European Diamonds, Inc. v. Burbank*, 684 F.2d 363 (6th Cir. 1982); *Bischoff v. Thomasson*, 400 So. 2d 359 (Ala. 1981). *Cf. W.N. Provenzano, Inc. v. Monahan & Co. (In re Monahan & Co.)*, 13 Bankr. 248 (Bankr. D. Mass. 1981); *Manger v. Davis*, 619 P.2d 687 (Utah 1980) (other cases involving attempts to sell or market gems by means of entrustment).

127. 20 Bankr. 627, 631 (Bankr. S.D. Ohio 1982).

business'' requirement of subsection 2-326(3) was designed to free factors, such as a traveling jewelry salesman, from the imputation rule. If, as this Article contends, ostensible ownership no longer serves as a valid rationale for the consignment rule of section 2-326, courts might dispense with the place of business requirement altogether.¹²⁸ If the valid rationale for the rule is the policy of treating all consignors as unsecured lenders, the place of business requirement is superfluous.

It is not necessary, however, to dispense with the place of business requirement to criticize the *Allsop* holding. The record in *Allsop* demonstrated that Roudebush did maintain a place of business—with another jeweler for one period and in an office building for another. If the consignor in *Allsop* had been a commercial venturer, it is difficult to see why the entruster should escape the fraud presumption that this Article advocates. The *Allsop* court could have avoided these harmful distinctions by resting its ruling on an explicit consumer exception.

*Bischoff v. Thomasson*¹²⁹ is another jewelry case. In *Bischoff*, however, the court went out of its way to reject some of the proconsumer decisions. Even if the entruster had been a consumer, the court held that it would not bend the rule to protect him.¹³⁰

In *Bischoff* the individual owner of a diamond ring entrusted it to a diamond merchant who maintained a place of business where he sold gems. *Bischoff*, the owner, who purchased the ring with plans for resale at a profit,¹³¹ clearly was a speculator. The court properly noted that he was not a consumer and that any inference in the *Allgeier* and *Fegett* cases that consumer consignors should escape subsection 2-326(3) was not available to Mr. *Bischoff*.¹³² *Bischoff's* lawyer, however, argued the applicability of the *Allgeier-Fegett* rule¹³³ and the court, in a thoughtful opinion, responded.

First, the court vigorously and correctly rejected the notion that parties can escape the rule of section 2-326 by showing that they intended to create only a bailment or agency relationship. Such an arrangement, the court held, is subject to the imputation rule of subsection 2-326(3), and, therefore, Mr.

128. Because the ostensible-ownership rationale no longer serves the consignment rule, courts might be justified in omitting from § 2-326(3) the requirement that the dealer maintain a place of business where he sells goods of the kind. That reading would carry this Article's thesis to its natural conclusion. Arguably, the result in these cases should not turn on the question of whether the dealer maintains such a place of business or whether he carried gems in his car or his brief case. In some of these cases the transient will have a business card, as Roudebush did in *Allsop*. The address on the card or the place where the transient has a telephone could be his place of business. If courts strictly enforce the place of business aspect of § 2-326(3), some true consignments will escape the imputation rule. Thus, in *Manger v. Davis*, 619 P.2d 687 (Utah 1980), the court concluded that three kinds of consignments exist: false consignments, which Article 9 governs; true consignments that fall into § 2-326; and true consignments that do not fall within § 2-326 and, therefore, are subject to general agency principles. *Id.* at 691-92.

129. 400 So. 2d 359 (Ala. 1981).

130. See *infra* text accompanying notes 132-35.

131. 400 So. 2d 359, 367 (Ala. 1981).

132. *Id.*

133. *Id.* at 366.

Bischoff's entrustment was a sale or return that rendered his ownership of the diamond vulnerable to the claims of the gem merchant's creditor.¹³⁴ With equal vigor the *Bischoff* court characterized *Allgeier* and *Fegett* as "maverick cases" and warned against eroding the "comprehensive statutory scheme of the UCC . . . [with] an ad hoc balancing of the equities."¹³⁵

The *Bischoff* court was unwilling to accept a consumer exception outside the statutory framework. The problem, then, is to provide a framework that will avoid the baleful consequences of these cases. On the one hand are courts that misconstrue the language of the section and resort to ad hoc justice, while on the other is the *Bischoff* court, which would deny protection to the consumer.

VIII. CONCLUSION

In the first instance, this Article attempts to provide a framework for a consumer exception from the language of the statute itself. It is difficult to draft legislation that meets all contingencies, and it is easy to propose different language for section 2-326 after it has been enacted. Thus, as the *Bischoff* court argued, if the drafters had intended to exclude consumer consignors from the provision they could have limited its application to transactions "between merchants," as they did in other provisions.¹³⁶ The possibility remains, however, that the drafters of the section did not consider the consumer consignor and did not anticipate the modern practices of creditors, which no longer rely on ostensible ownership, but either verify that ownership or rely on credit ratings. The drafters clearly knew that they had neither considered nor anticipated all possibilities. They provided, then, for such contingencies by stipulating in section 1-102, the first operative section in the Act, that the Code should be construed liberally to promote modernization of the law.¹³⁷ They suggested, moreover, that courts, having the benefit of hindsight, should limit application of each provision of the statute to its reason.¹³⁸ By adopting section 1-102, the legislatures have approved this case-code approach.¹³⁹

134. *Id.* at 367.

135. *Id.*

136. *Id.* The court might have added that the Code also has carved out explicit exceptions for the consumer transaction. *See, e.g.*, U.C.C. §§ 9-302(1)(d), -307(2) (1978). *Cf. supra* note 16.

137. U.C.C. § 1-102(1) (1978).

138. *Id.* comment 1.

139. *See id.* Professor Llewellyn illustrated the effect of the policy in a statement to the New York Law Revision Commission concerning complaints of a trade group. The group objected to the Code's risk-of-loss rule, which assumed that sellers insure sold goods that remain on their premises, because it would operate unfairly against farm sellers who do not carry such insurance. "I should have some hope that a court, seeing the reason for the rule announced in the comment, and knowing that farmers are not within that reason, might arrive at the conclusion that *for this purpose* the farmer who is so worrying the majority of the Commerce and Industry Association's Task Group would not be a merchant: *cessante ratione, cessat ipsa lex.*" 1 REPORT OF THE NEW YORK L. REV'N COMM'N FOR 1954, HEARINGS ON THE UNIFORM COMMERCIAL CODE 124 (1954) (testimony of K. Llewellyn) (emphasis in original). Thus, no need exists to amend § 2-326. The case-code aspect of the statute, exemplified in Professor Llewellyn's testimony, provides courts with the mechanism necessary to meet the exigency this Article describes.

The proper inquiry in consumer-consignor cases, then, is determining whether application of section 2-326 to the consumer serves a valid purpose. If creditors do not rely on a merchant's ostensible ownership of goods, but, instead, either verify that ownership by record searches, audits, and similar inquiry or rely on credit histories, then the ostensible-ownership doctrine is not a valid reason for the consignment rule of Article 2 under modern commercial practices. The rule does find support, however, in the idea that the law must discourage commercial entrusters that seek to use the consignment device to achieve a status more favorable than that accorded other parties which have unperfected security interests. Thus, it is more efficient to presume fraud—that is, to presume that the wholesaler is a secured party which should perfect—because the judicial costs and uncertainty in distinguishing true from false consignments in commercial entrustment situations is too great. It is more efficient to require both true and false commercial consignors to disclose their interests under either Article 9 or the exceptions to the consignment rule in subsection 2-326(3). Consumers, however, are not inventory lenders. Their consignments are always true consignments. Judicial costs and uncertainty do not attend consumer consignments, and the reason for the rule of subsection 2-326(3) does not apply to them. If the reason does not apply, the rule should not apply.

This Article's view that the Code should consider the status of a party is not new, as the Article's epigraph suggests.¹⁴⁰ The Code often resorts to status rules, providing, for example, special rules for banks¹⁴¹ and merchants,¹⁴² those dealing with farmers,¹⁴³ and those whom Professor Llewellyn thirty years ago called "housewives" and whom we now would call "consumers".¹⁴⁴ By introducing a status issue into the section, we add to the judicial burden. That addition, however, is generally modest and eliminates the need either to distort the statute to protect the consumer entruster or to follow the statute slavishly and deny the consumer protection.

Of course, ostensible ownership itself may be, as Justice Brandeis suggested in *Benedict*, an antifraud rule.¹⁴⁵ In that event, the purpose of the ostensible-ownership doctrine is to catch transactions in which the true owner is an inventory lender hiding his interest in a way that should render the interest unperfected. Commercial consignors come within that purpose, but consumer consignors, who are never inventory financiers, do not. An explicit consumer exception does no damage to the Code's solution to the commercial-consignment problem; rather, it prevents courts from wrecking the Code solution and avoids unfair treatment of consumers.

140. See *supra* p. 21.

141. See, e.g., U.C.C. § 5-102(1)(a) (1978).

142. See, e.g., *id.* § 2-103(1)(b).

143. See, e.g., *id.* §§ 9-109(3), -301(1)(c), -307(1).

144. See, e.g., *id.* § 9-307(2).

145. See *Benedict v. Ratner*, 268 U.S. 353, 363 (1925).

In the second instance, this Article attempts to demonstrate the need for reappraising the conventional justification for the Code's filing rules. If credit investigation in particular and credit practices in general have changed, as this Article contends they have, the ostensible-ownership justification is invalid, but an antifraud justification holds. Analysis of the consumer-consignor question illustrates the need to rethink application of the filing rules and suggests that a consumer who fails to file may nonetheless defeat a competing creditor. In the broader context this Article illustrates the need to test application of the Code filing rules in other situations, especially those concerning consumers, when those rules may satisfy ostensible-ownership concerns but may not satisfy antifraud concerns.

