

**UNRAVELING THE COMPLEXITIES OF  
CONSIGNMENT AGREEMENTS IN  
TRANSACTIONAL WORK, STATE COURT  
LITIGATION AND BANKRUPTCY  
PROCEEDINGS  
PART I**

**CLLA NATIONAL CONFERENCE  
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# **CONSIGNMENT: What Do Our Clients Think it is ANYWAY?????**

- ▶ **Trade creditors mistakenly believe it to be some kind of sale under Article 2 of the UCC?**
- ▶ **Our job is to Guide them properly**

# UCC 9-102(a)(20)

## Consignment Definition

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

# UCC Article 2-326

## Consignment Sales and Rights of Creditors

- ▶ **Sale on Approval**
  - ▶ Goods delivered primarily for use by the buyer
  - ▶ Goods not subject to claims of the buyer's creditors
- ▶ **Sale or Return**
  - ▶ Goods delivered primarily for resale
  - ▶ Goods are subject to claims of the buyer's creditors while in possession of the buyer

# UCC 9-319. Rights And Title of Consignee With Respect to Creditors and Purchasers.

- ▶ (a) [Consignee has consignor's rights.]
- ▶ Except as otherwise provided in subsection (b), for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.
- ▶ (b) [Applicability of other law.]
- ▶ For purposes of determining the rights of a creditor of a consignee, law other than this article determines the rights and title of a consignee while goods are in the consignee's possession if, under this part, a perfected security interest held by the consignor would have priority over the rights of the creditor.

# Consignments Under UCC Article 2

- **UCC § 2-401(a):** Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to reservation of a security interest.
- **UCC § 2-326:** If goods conforming to contract are subject to return by buyer, the transaction is a “Sale or return” if the goods are delivered primarily for resale and the goods are subject to the claims of buyer’s creditors while in buyer’s possession.

# UCC Article 9-103

## Purchase Money Security Interest

- ▶ A special type of security interest provided for under the Uniform Commercial Code (UCC) that enables a seller who sells goods on credit to obtain a superpriority security interest in the goods to secure the buyer's obligation to pay the deferred purchase price. This is possible even if the goods constitute after-acquired property of the buyer subject to a previously perfected security interest in favor of a third party, such as the buyer's asset-based lender (UCC § 9-324)

# UCC Article 9-324

## Purchase Money Security Interest/ Consigned Goods

- ▶ Perfection of consignment interest prior to the consignee's possession of the goods
- ▶ Delivery of a notice to the Holders of conflicting security interests
  - ▶ Must state that the consignor has or expects to acquire a consignment interest
  - ▶ Holder of conflicting interest must receive notice



# Perishable Agricultural Commodities Act (PACA)

- ▶ 7 U.S.C. Chapter 20A Sec. 499 *et seq.*
- ▶ Governs the conduct of any commissioned merchant, dealer or broker in connect with a transaction which involves any perishable agricultural commodity, meaning “ Fresh fruits and fresh vegetables of every kind and character; and ... cherries in brine as defined by the Secretary in accordance with trade usages.”
  - ▶ Perishable Agricultural Commodities can be fresh, frozen or packed in ice

# U.S. Department of Agriculture Rules & Regulations

- ▶ Consignment is NOT a sale. It creates an agency relationship between the consignor and the consignee, where the produce continues to belong to the consignor until the consignee sells it on the consignor's behalf. After such sale, the proceeds of the sale belong to the consignor, with the consignee allowed only to retain expenses of the resale and commission
- ▶ F.O.B. "free on board" - product is placed with the carrier at the shipping point in "Suitable Shipping Condition"
  - ▶ Buyer accepts the products at shipping point and has no right to reject the product
    - ▶ EXCEPT if the product is not in suitable shipping condition
- ▶ F.O.B. Acceptance Final - suitable shipping condition is inapplicable
- ▶ There is no other "sale" warranty applicable to consigned goods

# Code of Federal Regulations

- ▶ 7 CFR §46.2(aa) requires prompt payment in full.
  - ▶ For the purpose of determining violations of the PACA, “full payment promptly” means “payment of the net proceeds for produce received on consignment, or the pro-rata share of the net profit for produce received on joint account, within 10 days from the date of the final sale for each shipment, or within 20 days from the date the produce was received at destination, whichever comes first.”
- ▶ 7 CFR §46.2(bb) prohibits rejection without reasonable cause. Rejection without reasonable cause in connection with purchases, consignments or joint account transactions means:
  - ▶ Refusing or failing without legal justification to accept produce within a reasonable time;
  - ▶ Advising the seller, shipper, or his agent that produce, complying with contract, will not be accepted;
  - ▶ Indicating an intention not to accept produce through an act or failure to act inconsistent with the contract; or
  - ▶ Any rejection following an act of acceptance.

# STATUTES ASIDE: LET'S BE PRACTICAL

# Our Clients as Consignors

- **Creditor can give goods over to the care of another party**
  - **Retaining full ownership until property is sold**
    - **Commonplace in auctions, shipping, transferring goods or goods put up for sale not by owner but by third party**
    - **Commonplace in certain industries**
      - **Sporting goods**
      - **Diamond industry**

# Consignment Agreement Required

- ▶ **Identification of the parties**
  - ▶ The document should identify the consignor and the consignee.
- ▶ **Description of the goods**
  - ▶ The document should describe the goods being consigned, including their quantity, quality, and any special features.
- ▶ **Terms of the consignment**
  - ▶ The document should outline the terms of the consignment
    - ▶ duration of the consignment
    - ▶ sale price of the goods
    - ▶ commission payable to the consignee
    - ▶ any other relevant terms.

# Consignment Agreement Required

- ▶ **Representations and warranties**
  - ▶ The document should include any representations and warranties made by the consignor about the goods
    - ▶ Ownership
    - ▶ Condition
    - ▶ legality.
- ▶ **Dispute resolution**
  - ▶ The document should include a mechanism for resolving disputes between the parties.

# Notification Essential to Obtain a Perfected Consignment

- ▶ All secured parties and/or potential buyers must receive notification that goods are subject to a consignment agreement
- ▶ Notice must include
  - ▶ Identification of the consignor and consignee.
  - ▶ Description of the goods.
  - ▶ Statement that the goods are subject to a consignment arrangement.
  - ▶ Contact information for the consignor and consignee



# **SAMPLE**

## **Notification Verbiage For Consignments**

**PLEASE TAKE NOTICE THAT [Name of Creditor] HAS OR IS ABOUT TO ENTER INTO A CONSIGNMENT AGREEMENT WITH [Name of Customer] COVERING ALL GOODS OF CREDITOR [be specific] SOLD AND DELIVERED TO CUSTOMER. THESE GOODS REMAIN THE PROPERTY OF THE CREDITOR AND TITLE DOES NOT PASS UNTIL THEY HAVE BEEN PURCHASED BY A THIRD PARTY**

# Filing Necessary to Obtain a Perfected Consignment Interest

- ▶ UCC Financing Statement - similar to that used to perfect Security Interests - should be filed with the appropriate office
  - ▶ Generally: Secretary of State where Consignee is “located”
- ▶ Financing Statement must include
  - ▶ Identification of the consignor and consignee.
  - ▶ Description of the goods.
  - ▶ Statement that the goods are subject to a consignment arrangement.
  - ▶ Contact information for the consignor and consignee

# Consignment Agreement Complexities

- ▶ Work wonderfully while consigned goods are in possession of debtor/customer
- ▶ Potential Loss of Security when consigned goods are sold
  - ▶ Creditor must protect with multiple documents and security interests
- ▶ Prior Secured Party supersedes Consignor if notification and filing is not perfected

# CASELAW

# Evergreen Marine Corp. v. Six Consignments of Frozen Scallops

- ▶ 4 F. 3d 90, U.S. Court of Appeals, 1<sup>st</sup> Circuit (1993)
- ▶ Ocean carrier, which delivered frozen scallops to buyer without receiving bills of lading, brought conversion action when discharged scallops were seized by banks which held security interests in consignee's after-acquired inventory. The United States District Court for the District of Massachusetts, Robert E. Keeton, J., 806 F.Supp. 291, entered summary judgment for banks on carrier's conversion claim. Carrier appealed. The Court of Appeals, Cyr, Circuit Judge, held that: (1) conversion claim was governed by Massachusetts law rather than maritime law, and (2) ocean carrier had superior claim to scallops.

# Charles Bloom & Co. v. Echo Jewelers

- ▶ 279 N.J. Super. 372 Superior Court of New Jersey, Appellate Division, 1995
- ▶ Diamond wholesaler brought action for conversion against owners of jewelry store, seeking damages and finance charge. In nonjury trial, the Superior Court, Law Division, Union County, found no cause of action, and wholesaler appealed. The Superior Court, Appellate Division, Villanueva, J.A.D., held that corporate veil would not absolve store owners of potential liability for conversion

# Italian Designer Import Outlet, Inc.

v.

## New York Central Mutual Fire Insurance Company

- ▶ 26 Misc. 3d 631, Supreme Court, Kings County, NY (2009)
- ▶ Background: Insured retailer brought action against insurer, seeking to recover under businessowners special policy, which provided for business personal property coverage, for water damage to retailer's inventory after steam pipe burst at premises. Insurer moved for summary judgment.
- ▶ Holdings: The Supreme Court, Kings County, Jack M. Battaglia, J., held that: term “business personal property” in policy included all merchandise in which retailer had insurable interest, and transactions between retailer and supplier were “sale or return” transactions, and not “true consignment” transactions. Motion denied and summary judgment granted in favor of retailer.