The Treatment of Consignments in Bankruptcy: Two Codes and their Fictions, At Play, In the Fields

Ingrid Michelsen Hillinger
Boston College Law School, hillinge@bc.edu

Follow this and additional works at: http://lawdigitalcommons.bc.edu/lsfp
Part of the Bankruptcy Law Commons, and the Commercial Law Commons

Recommended Citation
Once upon a time, a long time ago (and certainly before there was a Commercial Code), the legal treatment of the “true” consignment matched the parties’ expectations. The parties viewed it as a bailment and the law treated it as such. The story of consignments was a simple one, whether it was told in or out of bankruptcy.

Today, the legal story is far more complex and interesting. It involves subplots, legal fictions and surprise twists. It can baffle persons not fully acquainted with the mysteries of both the Uniform Commercial Code (hereinafter, “U.C.C.”) and the Bankruptcy Reform Act of 1978 (hereinafter “Bankruptcy Code”). It can confuse even those who are.

This article recounts the consignment story as told by the caselaw. In the process, it tries to sort out legal myth from legal fiction in an attempt to describe legal reality.

I. THE BASIC PLOT LINE

Rodney owns a small jewelry store on Main Street, Smallville, U.S.A.. He sells the usual fare — gold, silver, and diamond items. Because diamonds are expensive, Rodney cannot afford to stock a sufficient number of diamonds in the variety necessary to meet customer demand and taste. Diamond, Inc. is a wholesale diamond company. Upon request from known retail jewelers, Diamond, Inc. will deliver, “on memoran-

* A.B., Barnard College; J.D., Marshall-Wythe School of Law, College of William & Mary. Associate Professor, Boston College School of Law.

Enormous thanks to Melissa Robinson, J.D. 1988, Marshall-Wythe School of Law, who selflessly joined me in pondering the imponderable, the bankruptcy case law dealing with consignments. Special thanks as well to Professor James (“I see a fraudulent conveyance here”) Rogers, my commercial law colleague at Boston College and David G. Epstein, Dean of Emory Law School, who read my manuscript armed with a fine tooth comb. Lastly, but not “leastly,” thanks to my husband, Mike, who somehow managed to both edit and finesse my “I need your support, not your criticisms” moods.

1 See, e.g., Ludvigh v. American Woolen Co., 231 U.S. 522 (1913); Edgewood Shoe Factories v. Stewart, 107 F.2d 123 (5th Cir. 1939).
“dum,” a parcel containing several diamonds of the general size, color, and type desired. The retailer will show the consigned diamonds to the customer. If the customer decides to buy one of the consigned diamonds, the retailer, with permission from Diamond, Inc., will conduct the sale. The retailer will pay Diamond, Inc. the wholesale value of the diamond. He will return any unsold diamonds to Diamond, Inc.

Over the years, Rodney has requested that Diamond, Inc. deliver approximately twenty diamonds a week. Typically, Rodney must return unsold diamonds to Diamond, Inc. before Diamond, Inc. will deliver a new consignment.

A defalcating employee, some mismanagement, and a wave of public interest in art deco jewelry caused Rodney to fall on hard times. On March 1, 1989, he petitioned for Chapter 11 relief under Title 11 of the United States Code. At the time he filed, he possessed twenty-five consigned diamonds having a fair market value of $25,000. During the ninety days preceding his filing, he had received and returned diamond consignments on a weekly basis. The value of each consigned parcel of diamonds was approximately $20,000. The parties had engaged in these weekly consignments and returns over a period of many years.

II. DIAMOND, INC.'S STORY AS TOLD BY THE UNIFORM COMMERCIAL CODE

The bankruptcy treatment of the consignment transaction depends mightily on its state law characterization. Thus, a discussion of the state law approach is a necessary prerequisite to any discussion of the consignment transaction in bankruptcy. The state law treatment is complicated. It involves several distinctions, at least two legal fictions, and a few implications. Not surprisingly, courts as well as others can lose their way in the state law labyrinth. When the consignment transaction enters the magical kingdom of bankruptcy, total confusion can reign.

A. The First State Law Distinction: “True” versus “Security Consignment”

Every school child knows the Uniform Commercial Code distinguishes the so-called “true consignment” from the “security consignment.” The Article 1 definition of “security interest” carefully draws the

* Although every school child knows the U.C.G. distinguishes between the “true” and the “security” consignment, Professor Winship has established that even the U.C.G. drafters did not fully agree
Consignments in Bankruptcy

"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)." Article 9, of course, regulates any transaction "intended to create a security interest." Thus, if Diamond, Inc. was really selling the diamonds to Rodney and simply reserving title to secure payment of their purchase price, the transaction would be a "security consignment." Conversely, if Diamond, Inc. and Rodney did not intend a sale, their transaction would represent a true consignment, a form of bailment. Rodney would have possession of the diamonds, but not legal title to them. Diamond, Inc.'s reservation of title to the diamonds would be a "real" reservation of title, and not a security interest. Diamond, Inc. would continue to "own" them.

Although the distinction is easy to state, it is not so easy to apply. In the Rodney-Diamond, Inc. transaction, arguably, the parties did not intend a sale. Rodney was not buying the delivered diamonds and Diamond, Inc. was not selling them. The parties engaged in the transaction hoping an eventual sale would occur. If one of Rodney's customers decided to buy a consigned diamond, a sale would occur. Rodney, acting as a selling representative or agent for Diamond, Inc., would conduct the sale. Rodney would pay the wholesale price to Diamond, Inc. and keep the difference as his sales commission. One could argue equally plausibly that the transaction is a form of inventory financing. Rodney cannot afford to stock his diamond inventory. Diamond, Inc. is thus financing Rodney's inventory by delivering diamonds to him.

Professor Hawkland limits the class of "true" consignments to "price-fixing devices." All other consignment transactions are security devices. The "consignor" overcomes the consignee's unwillingness to assume the risk of finding a market for the goods by agreeing to take back unsold,

---


* Article 2 characterizes a seller's retention or reservation of title to goods delivered to a buyer as "limited in effect to a reservation of a security interest." U.C.C. § 2-401(1) (1987).

---

but conforming goods. Under the Hawkland view, absent a "price-fixing" arrangement, all deliveries of goods represent security devices. The "consignor" is assured either the purchase price of the goods or their return. As such, the consignor is a secured seller.

Hawkland's view of the world of consignments does not appear to reflect the U.C.C.'s view. First, the U.C.C. discusses the transaction in which a seller seeks to overcome a buyer's unwillingness to assume the risk that the goods cannot be sold. Article 2 does so in connection with the "sale or return transaction." A "sale or return" is neither a consignment nor a secured transaction. Secondly, in a secured transaction, the seller, rather than the buyer, is arguably the "unwilling" party. The seller is unwilling to deliver goods to the buyer on the strength of the buyer's simple promise to pay. The secured seller does not beg the buyer to "please, please, please, take my goods." The secured seller does not, in desperation, agree to allow the buyer to return unsold goods.

From the standpoint of common sense, the Hawkland class of "true" consignments seems too narrow, his class of "security" consignments too broad. A lessor who leases goods is assured either lease payments, a return of the goods, or their value. Is the lessor a secured seller? The theft victim has a legal right to a return of her goods or their value; is she a secured seller?

Other commentators have rejected the Hawkland view. Richard Duesenberg, for one, argues that the true consignment involves a principal/agent relationship between consignor and consignee. Professor Gilmore thought the distinction should turn on whether the consignee has a right to return unsold goods. Professor Winship suggests recasting the Gilmore distinction "to focus on whether there is an obligation to pay the price of the goods to the consignor at the time of the consignment."

An occasional court, referring to and relying on the Hawkland article, will observe that the transaction represents a true consignment because it involves a price-fixing arrangement. A substantial body of case

---

9 Id.
13 Winship, supra note 2, at 849. Professor Winship's article discusses the various tests for distinguishing the "true" from the "security" consignment. Id. at 846-49.
law, however, analyzes the transaction under Article 2 rather than Article 9, suggesting that most courts have not adopted Hawkland's restrictive view. Most courts would characterize the Rodney-Diamond, Inc. transaction as a "true consignment" and, hence, beyond Article 9's purview.

B. The Second State Law Distinction: "Sale or Return" or Consignment?

If Article 9 does not regulate the consignment transaction, the U.C.C. directs our attention to Section 2-326. Section 2-326 describes four different transactions: (1) a "sale or return," (2) a consignment transaction which will be deemed a "sale or return" for some purposes; (3) a consignment transaction which will not be deemed a "sale or return," and (4) a consignment transaction beyond the U.C.C.'s scope.

The distinctions which Section 2-326 draws can quickly blur. The case law blurs them further. For instance, an opinion might describe the transaction as a "consignment sale," an oxymoron, if ever there was one, because the true consignment does not involve a sale.


3. The definition of security interest that excludes consignments which are not intended as secured transactions notes that the consignment is in any event subject to Section 2-326. U.C.C. § 1-201(37) (1987).


characterize the transaction as an "unperfected consignment" (a "security" and a "true" consignment all rolled into one?), or speak in terms of "goods consigned under a sale or return." One can hardly blame the courts for their confusion. Section 2-326 makes confusing distinctions.

1. Sale or Return

Because Article 2 sometimes treats the consignment transaction as if it were a sale or return, a discussion of the Article 2 "sale or return" is necessary.

If goods are delivered to someone primarily for resale, but can be returned even though they are conforming, Article 2 classifies the transaction as a "sale or return." The Official Comments seem to indicate a bit of drafter discomfort with characterizing this transaction as a contract for sale: "[t]his section . . . presupposes that a contract for sale is contemplated by the parties although that contract may be of the peculiar character here described."

Having created a "peculiar" kind of a contract, the drafters felt the need to discuss it further. Section 2-326(2) describes the legal consequences of a "sale or return" in terms of creditors of the buyer: "goods held on sale or return are subject to such claims [the claims of the buyer's creditors] while in the buyer's possession."

Who would doubt that a buyer's creditors could lay claim to goods sold and delivered to a buyer? A sale and delivery of goods presupposes a transfer of title to those goods. Do we really need the U.C.C. to tell us that? Perhaps we do because the legal legerdemain has already begun. The "sale or return" transaction may not be a REAL sale, at least as we understand the term "sale." Article 2 may be telling us to pretend that it is, at least while the goods are in the "buyer's" possession AND the rights of the "buyer's" creditors are at issue.

Indeed, the "sale or return" is a strange sort of sale. Presumably, in most sales transactions, both parties believe a sale has occurred when the seller delivers the goods to the buyer. Does the seller who "sells" goods under a "sale or return" reasonably believe she has made a sale when she

---


delivers the goods? Would she start to count her money then, or only when the period of return has come and gone and the buyer has not returned the goods? At what point does the “buyer” owe the purchase price? For that matter, what is the purchase price?

This “oddball” sale coupled with a discussion of creditor rights to the goods while in the buyer’s possession suggests the drafters were concerned with the problem of the “buyer’s” ostensible ownership of the goods. Creditors of a “buyer” in a “sale or return” transaction could easily conclude the “buyer,” in possession of the goods, owned the goods. To protect reasonable creditor assumptions, the drafters cast this marketing device as a “sale or return” to establish that the goods belonged to the buyer. The drafters quickly limited the effects of their characterization. The “sale or return” fiction only applies while the goods are in the “buyer’s” possession. The drafters presumably intended that, if and when the “buyer” returned the goods, the goods would be beyond the reach of the buyer’s creditors. The statutory language certainly suggests that intention. (Whether that intention can be effected is another matter. The drafters seem to have forgotten about fraudulent conveyance law).

Several implications flow from the “sale or return” characterization. Assuming a sale, we have not only a buyer and a seller, but also, one supposes, a debtor, a creditor, and a debt. The sale transfers title from the seller to the buyer. The seller is simply an unsecured seller with no rights in, or claim to, the goods. Of course, all the seller really wants is buyer’s payment. She just needs to wait patiently to see if the buyer keeps the goods. While the “seller” waits, creditors of the buyer can levy on those goods to satisfy their claims against the buyer. (Of course, if the buyer’s creditors seize the goods, the buyer cannot return the goods. If the buyer cannot return the goods, he owes the seller the full purchase price. The “sale or return” seller should therefore pray that her buyer’s creditors seize her goods, right?)

In the hypothetical, Rodney was not concerned about being able to market Diamond, Inc.’s diamonds. A ready market exists for diamonds. The Rodney-Diamond, Inc. transactions do not seem to be Article 2 “sales or return.”

---

C. The Third State Law Distinction: Consignments Described by Section 2-326

Section 2-326(3) describes a class of transactions which merit “special” legal treatment. Most “true” consignments “qualify.” Section 2-326(3) applies to all transactions in which the following three criteria are satisfied: (1) goods are delivered to a person for sale (true consignors always deliver their goods to a person for ultimate sale, that is the whole point); (2) that person (“the deliveree”) maintains a place of business under a name other than the name of the person who delivered the goods; and (3) the deliveree deals in goods of the kind delivered.

If the consignment transaction falls within Section 2-326(3), AND its exceptions do not apply, then, “with respect to claims of creditors of the person conducting the business the goods are deemed on sale or return.” Section 2-326(2) has already established that goods on “sale or return” are subject to the buyer’s creditors’ claims while the goods are in the possession of the buyer. Section 2-326(3), therefore, stands for the fol-

---


11 Parties have argued over whether Section 2-326 governs the transaction. Walter E. Heller & Co. v. Riviana Foods, Inc., 648 F.2d 1059 (5th Cir. 1981) involved a warehouse agreement in which Riviana delivered foods to the debtor for storage and delivery to Riviana’s customers. When the goods were sold by Riviana’s brokers, the debtor received 6.5% of the invoice price. The court concluded the transaction was not governed by Section 2-326. The debtor was given no specific authority to sell goods, nor was it ever invoiced, billed, or credited for any of the goods stored in the debtor’s warehouse. Consequently, the secured party’s security interest did not attach to Riviana’s goods. In dictum, the court noted that even if it had found a sale, it would have refused to read Section 2-326 literally. Id. at 1062. The statute was designed to minimize prejudice to creditors of the consignee where the creditor could be misled. On the facts, the creditor had extended credit before the goods had been delivered. If indeed the goods were not delivered to the debtor for sale, Section 2-326 does not apply. The transaction would represent a true bailment of goods.

In BFC Chemicals, Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985), the consignor delivered chemicals to the debtor who used them to formulate agricultural compounds which the debtor then sold. The consignor argued that Section 2-326(3) did not govern because the debtor did not sell the chemicals in their delivered state and, hence, there was no delivery for sale as required by the statute. Id. at 1015. The court rejected the argument stating that courts are “reluctant to find that goods delivered to a person who “deals” in like goods does not in fact have authority to sell such goods, irrespective of the form of the sale.” Id. See also, In re Ateco Equip., Inc., 17 Bankr. 230 (Bankr. W.D. Pa. 1982).

12 Section 2-326(3) also describes certain circumstances under which the subsection does not apply. U.C.C. § 2-326(a)-(c) (1987). Basically, a properly publicized consignment transaction will not be characterized as a sale or return.

13 U.C.C. § 2-326(3) (1987) (emphasis added). Although this section can apply to transactions other than consignments, the consignment transaction is the usual situation in which someone delivers goods for sale to another who maintains a place of business in which he deals in goods of the kind.
lowing proposition. With respect to consignment transactions governed by Section 2-326(3) (that is, most true consignments), the consignment transaction will be deemed a “sale or return” insofar as the claims of the consignee’s creditors are concerned. This means consigned goods are subject to the claims of the consignee’s creditors while they are in the consignee’s possession.

By recharacterizing the vast majority of true consignments as “sale or return” transactions vis-a-vis the consignee’s creditors (while the goods remain in the consignee’s possession), the drafters again were attempting to deal with the ostensible ownership problem which the consignment transaction can create. The U.C.C. drafters were not out to destroy consignors, the consignment transaction, or its commercial utility. They were out to destroy secret liens.

Because (1) Diamond, Inc. delivered diamonds to Rodney for sale (ultimate sale); (2) Rodney did business under the name “Rodney,” not “Diamond, Inc.;” and (3) Rodney dealt in diamonds, Section 2-326(3) applies to their transactions.

D. The Fourth State Law Distinction: Consignments Governed by Section 2-326(3) That Are Not Deemed A Sale or Return

Because the drafters deliberately recharacterized the legal nature of the consignment transaction to deal with a specific problem — hidden liens — they limited the circumstances under which their fiction would operate. Consignment transactions that did not create a hidden lien were to be left alone. Thus, the sufficiently publicized consignment transaction would continue to be, at law, what it had always been: A consignment. The “sale or return, making goods subject to the claims of the consignee’s creditors while the goods are in the possession of the consignee” fiction, would not apply.

Section 2-326(3) sets out three different alternatives that allow the consignment to be treated as a consignment at law. If one of the three notice alternatives is satisfied, the transaction will not be deemed a “sale or return.”

---

58 In the August 1948 Draft of the U.C.C., Article VII (Secured Commercial Transactions), Section 301(2) dealing with the scope of the Article, provided: “The provisions of this Chapter also govern . . . (b) with respect to rights of third parties, a consignment of goods whether or not the consignee is obligated to the consignor.”


First, the consignor can give notice of its ownership interest in consigned goods by complying with any applicable law "providing for a consignor’s interest or the like to be evidenced by a sign."\(^{38}\) Unfortunately, this option does not offer much hope for the true consignor. Today, "sign laws" continue on the books only in North Carolina and Mississippi.\(^{38}\) Thus, the consignor in Massachusetts who labels goods, puts notices on shelves, or tags barrels has not given sufficient notice.\(^{37}\) Even in North Carolina or Mississippi, it would be difficult to tag or otherwise label diamonds.

Second, the consignor can fend off the "sale or return" characterization by establishing that "the person conducting the business [the consignee] is generally known by his creditors to be substantially engaged in selling the goods of others."\(^{38}\) The case law indicates consignors should not rely on this path to achieve salvation.\(^{39}\)

The final alternative — and as a planning matter, the consignor’s only real alternative — is to comply with the Article 9 filing provisions.\(^{40}\) An Article 9 filing, assuming it is possible, is the easiest and the only reliable form of protection. For Diamond, Inc., compliance with Article 9 may not be possible\(^{41}\) or, in light of the secrecy shrouding the trade, it


\(^{41}\) Section 2-326(3)(c)’s reference to compliance with the Article 9 filing requirements suggests a transactional similarity between the consignment and the Article 9 security interest. Section 2-326’s general complexity has spawned confusion. It is no wonder that the consignment contract “has been
may not be commercially feasible. This may explain why so much of the consignment case law involves jewelry. Alternatively, it may be that “news” of the U.C.C.’s recharacterization scheme has not yet reached the jewelry trade which relies on consignment transactions to conduct business.

If Diamond, Inc. satisfies one of the three notice alternatives, its consignment transactions will be treated at law as they were intended in fact. If Diamond, Inc. fails to satisfy any of the three alternatives, its diamonds, while in Rodney’s possession, will be available to satisfy the claims of Rodney’s creditors, at state law or in bankruptcy. Furthermore, in Rodney’s bankruptcy, consigned diamonds Rodney had returned to Diamond, Inc. may also be available for Rodney’s creditors.

State Law Confusion

Section 2-326 has generated considerable confusion. In applying it, some courts have reached conclusions the U.C.C. did not intend — e.g., that the true consignment is really a secured transaction. That conclusion is not difficult to reach, once you get the hang of it. The judicial reasoning goes something like this. Step 1: This is a true consignment and

denominated as ‘sale,’ regarded as ‘security’ and treated as ‘bailment’ or ‘agency.’” Hawkland, Consignments, supra note 8 at 395. The U.C.C. has given the consignment a multiple legal personality.

Mr. Weiner, President of the North American Diamond Consortium Inc., wrote a fascinating article arguing that compliance with the Article 9 filing requirements was not feasible for the diamond trade. Weiner, The Diamond Industry’s Dilemma: UCC Consignment Provisions, 17 U.C.C.L.J. 99 (1984). He wrote:

Because of the vast financial resources necessary to finance the keeping of complete stocks of inventory, it is both impractical and imprudent for any one diamond firm, no matter how large, to maintain a complete line of inventory in all shapes and sizes. Rather, dealers “lend” each other the desired diamond sought through the medium of an “all risk, for inspection only” memorandum.

Id. at 101. He argues that the enormous mobility of the goods “makes the filing process impracticable.” Id. at 103.

Mr. Weiner suggests that “[u]ntil recently, these trade practices [in diamonds] have been shrouded in secrecy because of the astronomical sums and high risk involved in each transaction.” Id. at 99.

At the conclusion of his article, Mr. Weiner suggests as much: “The industry must be made aware of the fact that it is operating under a pre-U.C.C. conception of vendor-buyer, consignor-consignee rights and that in order to better protect its interests under the present Commercial Code, it must turn to a different method of conducting business.” Id. at 113. He recommends delivering diamonds on a “cash/check sale” basis or a “postdated check sale” basis. Id. at 105-10.

See text accompanying notes 125-68.


therefore, Article 2, not Article 9, governs. Step 2: Section 2-326(3) applies. Step 3: The consignor did not comply with any of the notice options. Therefore, the transaction is deemed a "sale or return." (So far, so good.) Step 4: The parties' agreement provides that the consignor retains title to the consigned goods. Step 5: Section 2-401 establishes that a seller's retention of title regarding delivered goods is limited, in its effect, to reservation of a security interest. CONCLUSION: This is a secured transaction and the consignor is just another unperfected secured party.

Working backwards, that conclusion cannot be right. It collapses the U.C.C.'s carefully drawn distinction between the "true" and the "security" consignment. That is what happens when a court mixes reality (the parties' contract terms) with fiction. No wonder this area (the Article 2 characterizations) is confusing.

In resolving consignor-consignee disputes, several courts have announced unabashedly that the "intent [of the parties] is no longer determinative" because the U.C.C. establishes that a sale has occurred. Another court stated that title "vests" in the consignee unless the consignor does something. In fact, the U.C.C. supports neither proposition. It carefully limits the effects of its fictions, be it the "sale or return" or the "consignment deemed a sale or return" fiction. The fiction only applies to disputes between the owner of the goods and creditors of the consignee/buyer and then, only while the goods are in the consignee/buyer's possession. In all


48 Other types of confusion abound. A court may talk in terms of "perfecting priority." In re Lebus-Albrecht Lumber Co., 38 Bankr. 58, 61, (Bankr. D.N.D. 1984). An opinion may say title passed because it was a sale, or possession passed but title was reserved but either way, there was no filing and hence the consignor loses his ownership claim. In re Louis Burk Co., 6 U.C.C. Rep. Serv. 423 (Bankr. E.D. Pa. 1969).

One court relied on Section 9-301(1)(b) to determine priority between a non-publicized consignor and a lien creditor. Columbia Internat'l Corp. v. Kempler, 46 Wis.2d 550, 175 N.W.2d 465, 7 U.C.C. Rep. Serv. 650 (1970).


The Texas Supreme Court straightened out the lower court in Fuller. The court noted that the Section 2-326(3) "sale or return" characterization does not apply to the parties to the transaction or their assignees. It only applies when the rights of third party creditors intervene. 644 S.W.2d at 443, 35, U.C.C. Rep. Serv. at 1158.

In one case, the result was right. The consignor was suing the consignee for goods which had been stolen from the consignee. The consignee defended on the basis that the transaction was a consignment. The court rejected the argument, concluding that as a matter of law, the transaction was a sale or return. Collier, 471 S.W.2d at 154, 9 U.C.C. Rep. Serv. at 1216.

other situations — for example, a controversy between the parties to the transaction — the parties' own agreement controls. One court "got it" when it correctly observed the transaction can be two things at once: a "sale or return" as to creditors and a consignment as between the parties.\textsuperscript{81}

Other confusions abound. Occasionally, a court has erroneously invoked Section 2-326(3).\textsuperscript{82} In one case, the court concluded that display racks which the consignor delivered along with record albums were available to creditors in the consignee's bankruptcy.\textsuperscript{83} Another court held that floor samples and displays were likewise available to creditors.\textsuperscript{84} Another court came to the right conclusion for the wrong reason. It concluded that racks delivered to stack L' Eggs stockings were not available to the consignee's creditors. The delivery of the racks represented a true consignment because the consignee did not deal in display racks.\textsuperscript{85}

Needless to say, Section 2-326(3) only applies to goods delivered for sale. Equipment used to assist or promote sales is not for sale. Such items are most assuredly beyond Section 2-326(3)'s scope.\textsuperscript{86} Because such equipment is not delivered to the consignee for eventual sale, their delivery does not involve a consignment.

E. The Fifth State Law Distinction

If Section 2-326(3) does not describe the transaction and no other part of Section 2-326 applies, the U.C.C. relinquishes control.\textsuperscript{87} The rights of the deliverer of goods that the U.C.C. "abandons" are governed by the common law.\textsuperscript{88} He or she is one lucky deliverer.

\textsuperscript{84} In re Marcoly, 32 Bankr. 423 (Bankr. W.D. Pa. 1983).
\textsuperscript{86} An early U.C.C. case concluded as much. In re Keith, 1 U.C.C. Rep. Serv. 347 (Bankr. W.D. Pa. 1962) (cash register loaned to debtor while his was being repaired represented a simple bailment relationship. Title was not intended to pass. The bailor retained title without the need for a filing). See also, Cattle Owners Corp. v. Arkin, 252 F. Supp. 34 (S.D. Iowa 1966).
\textsuperscript{88} See, e.g., In re Fuel Oil Supply & Terminaling, Inc., 72 Bankr. 752 (S.D. Tex. 1987), rev'd on other grounds, 837 F.2d 224 (5th Cir. 1988) ("exchange and loan agreement regarding oil is a
Similarities And Differences Between the State Law Treatment of the Consignor and the Article 9 Secured Party

Both true consignors and secured creditors who hold a non-possessory lien have a claim to or interest in property in the possession of another. Both interests can create a hidden lien. Both interests, therefore, can lead to the appearance of ownership in another. Requiring public notice of the interest to make it legally effective against others protects third parties who deal with the consignee or debtor. In this sense, consignors and secured creditors are alike.

If they are alike, their legal treatment should be alike as well. In fact, the U.C.C. treats them differently. The true consignor who, by definition, assumes it owns the goods, receives less protection and less favorable treatment than the secured creditor who knows its interest is less than an ownership interest. This discrepancy in state law treatment creates a potential discrepancy in bankruptcy as well.

The claim of the unperfected secured creditor is not subject to, or subordinate to the general, unsecured creditor, while the unfiled consignor's ownership claim is. Section 2-326(2) establishes that while goods are in the possession of the buyer [consignee], they are subject to the claims of the buyer's creditors. Article 1 defines "creditor" to include unsecured creditors as well as lien creditors and Article 9 secured parties.

Section 2-326(2)'s language making goods subject to the claims of the buyer's creditors may simply signify that the U.C.C. is overriding the common law position that creditors of a consignee could not attach consigned goods. That is, the drafters may have drafted the language to establish that a creditor can legitimately seize consigned goods in the consignee's possession.

If the drafters were attempting to solve the problems created by os-
Consignments in Bankruptcy

1989] 87

tensible ownership, how does their "solution" protect the creditor who extends credit in reliance on the consignee's ostensible ownership of consigned goods? Does it make sense to say, "O.K., creditor, you were deceived. You lent on the strength of goods the debtor did not own. But, as luck would have it, the goods are now safely back with the consignor and therefore, totally unavailable to you, despite your clear and reasonable reliance?" Maybe the drafters assumed consigned goods would remain in the consignee's possession. Perhaps the drafters were following a rule of limited engagement and were only willing to intrude upon the true consignment just so far. The statutory language as written, coupled with the policy driving it, permits another far more expansive interpretation. A creditor, any creditor, general as well as liened, who relies on the consignee's ostensible ownership of consigned goods, has a claim to those goods which is superior to the consignor's ownership claim.

A further discrepancy exists under the U.C.C. between the consignor and the Article 9 secured party. In the Rodney-Diamond, Inc. hypothetical, all the consigned diamonds were in the consignee's possession for a limited period of time. The drafters made provision in Article 9 for the short-lived ostensible ownership problem. They dispensed with the need for a filing or other notice, allowing automatic perfection for a twenty-one day period. True consignors like Diamond, Inc. would kill for such a provision.

III. THE SECOND STATE LAW FICTION

With the 1972 amendments to Article 9, the U.C.C. has indulged in a further fiction regarding the true, but non-publicized, consignment. According to Article 9, a security interest cannot attach unless the debtor has rights in the collateral. That is bedrock law . . . with one apparent exception. The claim of an Article 9 secured party to consigned goods can have priority over the consignor's ownership claim to them. If the Article 9 secured party can obtain priority to consigned goods, one assumes that, somewhere along the way, the Article 9 secured party has acquired a security interest in the consigned goods. If so, the secured party has acquired a security interest in goods in which the debtor/consignee has only a possessory right.

Section 9-114 does not exactly say that, but, in substance, that is its

---

result. Section 9-114 is expressed in the subjunctive. Subsection (1) establishes that if the consignor complies with all its requirements, the consignor's claim has priority over the perfected secured party "who WOULD HAVE a perfected security interest in the goods IF THEY WERE the property of the consignee. . . ."44 If the consignor is required to file45 and fails to comply with the Section 9-114 requirements, Section 9-114(2) describes the consignor's fate:

[i]n the case of a consignment which is not a security interest and in which the requirements of the preceding subsection have not been met, a person who delivers goods to another is subordinate to a person who would have a perfected security interest in the goods if they were the property of the debtor.46

One court, resolving a consignor–Article 9 creditor dispute prior to the 1972 amendments, reasoned that the term "rights in the collateral" did not signify title, but merely some rights which might be transferred to a secured party.47 In a way, Section 2-326 supports that reasoning. The unpublicized consignment transaction is a sale for purposes of on-looking creditors of the consignee. As a sale vis-a-vis the consignee's creditors, the consignee would "have title" and therefore, would have an interest in the goods sufficient to create a security interest.

In fact, a Section 2-326 analysis, on its own, would permit recognition of an Article 9 security interest in consigned goods. Consigned goods in the consignee's possession under a non-publicized consignment are subject to the claims of the consignee's creditors. An Article 9 inventory financer is a U.C.C. creditor.48 It has a claim to the debtor's inventory.

45 One court concluded that Section 9-114 only applies if Article 2 requires a filing. Article 2 only requires a filing if the other notice provisions are not satisfied. See, e.g., BFC Chemicals, Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).
47 Nasco Equipment Co. v. Mason, 291 N.C. 145, 229 S.E.2d 278, 20 U.C.C. Rep. Serv. 761 (1976). See also Susen Rubber Co. v. Hertz, 19 Ohio App.2d 1, 249 N.E.2d 65, 6 U.C.C. Rep. Serv. 769 (1969) (As far as creditors are concerned, such property may be treated as if owned by the debtor. After-acquired property clause should not be limited to property in which debtor acquires an ownership interest. The consignor's notification of the consignment to the secured creditor did not affect this result.)
Therefore, as night follows day, the secured party acquires a security interest in consigned goods by operation of Section 2-326. The after-acquired property clause in its security agreement just scoops up the goods. At one level, then, Section 9-114 simply reiterates and clarifies a thought begun in Section 2-326.70

The distinction between "powers" and "rights" may also justify the secured party's acquisition of a security interest in consigned goods. Under 2-403(2), a true owner who entrusts possession of his goods to someone who deals in goods of the kind thereby gives the entrustee the power to transfer good title to a buyer in ordinary course.71 Under Section 2-326(3), the consignor who delivers its goods to the consignee for sale arguably creates a similar power in the consignee to create a security interest in the consigned goods. If the consigned goods are available to the consignee's general creditors, it makes little sense to conclude that they are unavailable to the Article 9 secured creditor.

At another level, Section 9-114 may add a thought or two. First, under one reading of Section 2-326, if the consignor can retrieve its goods before a creditor seizes them, the consignor seems to be home free. Not so under Section 9-114. Once a security interest attaches, it exhibits great sticking power. It remains unless some other Article 9 provision unglues it.72 The Article 9 secured party can retrieve "its" goods from the consignor. As a result, the consignor's failure to publicize its interest increases the Article 9 creditor's security. Look at it as the consignor's personal contribution to the health and well-being of the Article 9 secured party.

---

71 "Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him the power to transfer all rights of the entrustee to a buyer in ordinary course of business." U.C.C. § 2-403(2) (1987).
Compliance with the Article 9 filing requirements alone does not protect the consignor from the Article 9 creditor.\(^{78}\) Section 9-114 requires the consignor to follow further formalities to establish its ownership claim as superior to that of the Article 9 creditor.\(^{74}\) If the consignor fails to comply with Section 9-114, then, by legislative fiat, consigned goods immediately and forever thereafter become caught in the net cast by the Article 9 secured party's after-acquired property clause. The secured party's claim to the goods continues in those goods even after they have left the consignee's possession.\(^{75}\)

Adding insult to injury, most courts allow the secured party to prevail even if it knows the goods are consigned.\(^{76}\) Only a few courts have recognized the unfiled consignor's ownership claim as against the secured party who has knowledge of the consignment.\(^{77}\) The judicial refusal to recognize knowledge as a relevant factor in consignor-secured party disputes is as wholly consistent with the Article 9 scheme as it is wholly inconsistent with the Article 2 treatment of ownership rights. Courts reject knowledge as a factor affecting priority under the Article 9 system because that would create uncertainty, the hobgoblin of Article 9.\(^{76}\) In contrast, the Article 2 treatment of ownership rights involves considerations of good faith and knowledge. For instance, under the entrusting provision, only a

---


\(^{74}\) Section 9-114(1)'s formalities track the formalities required for an inventory secured party to acquire super-priority under Section 9-312(3).


\(^{77}\) "Where notice is required for the purpose of giving actual rather than constructive knowledge, the prescribed notice is of more importance than the knowledge itself." In re State St. Auto Sales Inc., 81 Bankr. 215 (Bankr. D. Mass. 1988). The court also stated that "it would be a clear distortion of this statutory scheme for the court to write a knowledge restriction into § 9-114 merely because of its relationship with § 2-326." Id. at 220.


\(^{77}\) See, e.g., Limor Diamonds, Inc. v. D'Oro By Christopher Michael, Inc., 558 F. Supp. 709 (S.D.N.Y. 1983) (it is not clear that an Article 9 secured party acting in bad faith is necessarily superior to an unpaid seller); GBS Meat Indus. Pty. Ltd. v. Kress-Dobkin Co., 474 F. Supp. 1357, 27 U.C.C. Rep. Serv. 388 (W.D. Pa. 1979) (policy behind Section 2-326 is to protect secured parties from being misled. The provision should not be read so narrowly to allow a secured party with knowledge to take consigned goods).

\(^{78}\) In re Smith, 326 F. Supp. 1311 (D. Minn. 1971).
buyer in ordinary course can defeat a true owner’s ownership claim. To qualify as a buyer in ordinary course, the buyer must buy in good faith and without knowledge that the sale is in violation of the ownership rights of a third party. Under Section 2-403(1), a transferor with voidable title to goods can only transfer good title to a purchaser who takes in good faith. The U.C.C. definition of “purchaser” includes the secured creditor. For the secured creditor to defeat the true owner’s claim under Section 2-403(1), it must act in good faith. One assumes a creditor would not be acting in good faith if it took a security interest in goods it knew to belong to someone other than its debtor.

A clear conflict exists between the Article 9 and Article 2 treatment. Because concern for hidden interests underlies the Article 2 treatment of consignments, and the consignor’s interest is not hidden from the secured creditor who knows the goods are consigned, policy objectives as well as considerations of fairness suggest the consignor’s ownership interest should prevail. One thing is clear from the state law treatment of consignments. Once a fiction is born, it can take on a life of its own. That reality creates further complications.

To conclude the state law analysis of the Diamond, Inc.-Rodney hypothetical, if an inventory financer holding a perfected security interest in Rodney’s inventory existed, that secured party would have a superior claim to Diamond, Inc.’s diamonds.

IV. THE BANKRUPTCY TREATMENT OF CONSIGNMENTS

A. Goods in the Consignee/Debtor’s Possession at the Time of The Bankruptcy Petition

As we left the parties, Rodney had petitioned for relief under Chapter 11. At the time, Rodney was in possession of a parcel of diamonds and Diamond, Inc. had not filed or otherwise complied with Section 2-326 of the Uniform Commercial Code. Whether Diamond, Inc. seeks relief from the automatic stay to recover its diamonds or Rodney, qua “Debtor-in-Possession” (“DIP”), seeks to sell the diamonds free and clear of Diamond, Inc.’s interest, the basic bankruptcy issue will remain the same:

---

79 U.C.C. § 1-201(9) (1987).
81 U.C.C. §§ 1-201(33) and (32) (1987).
82 Of course, that approach does create uncertainty for the Article 9 secured party. He may well rely on Section 9-114 to conclude that consigned goods are subject to his interest and then extend credit to the debtor; forbear from calling his loan; etc.
Will bankruptcy recognize Diamond, Inc.’s non-publicized ownership claim? Although most courts have concluded that bankruptcy will not recognize Diamond, Inc.’s ownership claim, they have taken completely different paths to reach that conclusion.83

1. A “Priority” Analysis and Variations on the Theme

As noted, the non-publicized consignor resembles the unperfected secured party; both hold a secret lien and both failed to do what they were supposed to do, viz., give public notice of their interest. As further noted, the U.C.C. further blurs its already confusing distinctions between “security interest,” “sale or return” and “true consignment” by permitting the true consignor to publicize its ownership interest through an Article 9 filing.

It is always easiest to do what you already know. Courts know how to analyze the bankruptcy status of an unperfected Article 9 secured party. Because the unfiled consignor appears to resemble the unperfected secured creditor, it is tempting to treat the unfiled consignor like an unperfected secured party. Indeed, some courts have.84 Some have gone even further and treated him as a secured party.85 These opinions are often opaque regarding the court's characterization of the transaction as either a disguised secured transaction or a true consignment.86 For some courts, “true or bogus” is apparently a distinction without a difference in bankruptcy.87


85 For instance, the court might reason that the defendant did not file a financing statement regarding consigned goods. He therefore holds an unperfected security interest which is subordinate to the rights of lien creditors and hence the trustee's interest in the goods is superior to that of the defendant. In re Florida Consumer's Furniture Warehouse, Inc., 9 Bankr. 76 (Bankr. S.D. Fla. 1981).


87 One court has suggested that title either passed to the debtor along with possession or that title was retained. The court, however, continued by saying that whether title was passed along with possession or whether it was retained, did not matter because, either way, the consignor had not filed and therefore could not prevail on either theory. In re Louis Burk Co., 6 U.C.C. Rep. Serv. 423
Courts evaluating the consignor’s bankruptcy status under Section 544 often speak in terms of “the trustee’s priority over the consignor’s claim.” Because the bankruptcy trustee has “priority” over a secured creditor who is unperfected on the date of the petition, these courts may simply be applying an Article 9 analysis to the non-publicized consignor.

Loosely translated, the bankruptcy trustee, under Section 544(a), has the rights and powers of, or may avoid any transfer of property or obligation incurred by the debtor, that would be voidable by an execution lien creditor (among others) who appeared at the commencement of the case. To determine the trustee’s “actual” rights and powers under Section 544, courts must refer to state law.

Article 9 states the relevant state law for secured creditors. It establishes that “an unperfected security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected.” A lien creditor at state law would have “priority over” an unperfected secured party. Section 544(a) allows the bankruptcy trustee to avoid the security interest in toto.

This Article 9 “perfection-priority” mode of analysis often appears in the consignment cases. For instance, one court stated: “the [p]laintiff [consignor] has an unperfected security interest in the diamond[s] subject to the [t]rustee’s rights.” Another court explained: “[s]ection 544 gives the Debtor in Possession a perfected interest in the goods superior to that of Star [the consignor].” In *In re BRI Corp.*, the court concluded that consigned goods and their proceeds were subject to the claims of the debtor’s creditors and the trustee under Section 544(a) and hence, the con-

---


*In re Mareoly*, 32 Bankr. 423, 425 (Bankr. W.D. Pa. 1983). The court was clearly uncomfortable with its conclusion. At one point, it noted that it found equity to be on the side of Star, the consignor. *Id.* at 424. It also noted that its opinion did not preclude Star from showing that the debtor’s creditors knew the debtor dealt in the goods of others. *Id.* at 425.

The true consignor's claim to priority status was defeated. In a footnote, the court discussed the trustee's power to avoid any transfer that would be avoidable by a judicial lien creditor. Given this power, the court reasoned that the trustee had the power to prevail over creditors with unperfected security interests and unsecured claims.

The analysis in these cases is, at a minimum, disconcerting. Occasionally, it can be downright baffling. The true consignor holds only an unperfected security interest? The trustee, as lien creditor, can prevail over an unsecured claim? The trustee is avoiding a transfer when he avoids the consignor's ownership claim?

As noted in a previous section, some courts have collapsed the distinction between a true consignment and a security consignment. If a true consignment is ultimately nothing more than a secured transaction, and the consignor's interest nothing more than an unperfected security interest, it makes perfect sense to rely on the Article 9 paradigm. In that case, of course, the unfiled consignor's interest will be subordinate to the bankruptcy trustee and the DIP can set it aside. When the dust settles, the consignor is left with a general, unsecured claim.

There is something distinctly disconcerting about invoking the "lien avoidance" aspect of Section 544 to vitiate a consignor's claim. The true consignor's interest in goods does not involve a transfer or obligation incurred by the debtor. If there is no debtor transfer or obligation to avoid in this context, does it make sense to speak in terms of the trustee "avoiding" it?

Sometimes, perhaps wisely, the court will not refer to any particular Bankruptcy Code provision, but will simply conclude the consignor failed to protect its interest and therefore, "the claimant loses its superior interest to the trustee." A court might also simply conclude, without analysis, that the DIP or trustee, as a result of Section 544, is in a superior position to that of the consignor.

Judicial reliance on an Article 9 model to analyze the non-publicized consignor's bankruptcy situation does not make much sense. The true con-

---

97 Id. at 75.
98 Id. at 75, note 3.
99 See supra notes 39-42 and accompanying text.
101 Id. at 582-83.
102 Id. at 583.
103 Id.
signor owns the goods. It is not a creditor (in normal parlance anyway), secured or unsecured, . . . filed or unfiled. The consignee’s possession of goods does not involve a debtor transfer or obligation that the trustee can avoid under Section 544(a). The trustee’s invocation of Section 544(a) “avoids,” not a debtor transfer or obligation, but rather the consignor’s ownership claim.

Furthermore, taken to its logical extreme, a “priority over the consignor” analysis would completely erode the bankruptcy position of the unfiled consignor. A party’s bankruptcy position depends, in large part, on its position under the state law priority scheme. Section 2-326 clearly establishes that consigned goods are subject to the claims of the consignee’s creditors. If Section 2-326 states a priority rule, it is saying the non-publicized consignor’s claim to the goods is subordinate to all creditors, unsecured as well as lien creditors. Therefore, at state law, any and all creditors would have priority to the goods as against the unfiled consignor while the goods are in the consignee’s possession.

If the consignor’s claim to the goods is subordinate to the claims of all creditors at state law, would not the consignor’s bankruptcy claim rank below the claims of unsecured creditors? If so, the unfiled consignor would receive a bankruptcy distribution only if the bankruptcy distribution fully satisfied all unsecured claims, an occurrence as common as hen’s teeth.

Analyzing the consignor’s situation in terms of priority or in terms of subordination of its claim to the claims of all creditors could effectively obliterate the unfiled consignor’s rights in the consignee’s bankruptcy. That result seems harsh. It is certainly harsher than the treatment accorded the consignor’s cousin, another secret lien holder, the unfiled secured party.

No court has yet subordinated the consignor’s claim to the claims of unsecured creditors. After the trustee is done with him, the consignor winds up with an unsecured claim on a par with all other unsecured claims. This result may arise because courts reflexively analogize the unfiled consignor’s situation to that of the unfiled secured party. The courts’ failure to discuss subordination could also be totally fortuitous, a

---

107 The U.C.C. defines “creditor” to include creditors of all kinds, unsecured as well as secured. U.C.C. § 1-201(12) (1987).
product of colossal judicial confusion. On the other hand, maybe courts intuitively understand subordination would be unfair, and subconsciously avoid that result.

But, if Section 2-326 states a priority rule, and the trustee under Section 544 is asserting lien creditor priority on behalf of all unsecured creditors, logically, albeit devastatingly to the consignor, the consignor's claim should be subordinated to the claims of all unsecured creditors. Perhaps Section 2-326 does not state a priority rule.

2. An Alternative Analysis: The Consigned Goods are Property of the Estate

In *In re Pro-Med Co.*,109 the consignor asked the court to set aside the trustee's sale of property because it, not the debtor, owned the property. Judge Britton used a "property of the estate" analysis to deny the request. First, he noted that goods delivered to a person for sale "are subject to the claims of creditors of the consignee unless the owner of the goods brings himself within one of the three statutory exceptions."110 He then noted that none of the exceptions applied. The consignor argued "the trustee should not be permitted to avail himself of the protection provided by the UCC . . . [and] that the creditors in bankruptcy do not fall within the class intended to be protected."111 (Reading between the lines, the consignor may have been arguing that the trustee is not a reliance creditor and, hence, should not receive the protection Section 2-326 provides.) In response, the court stated: "UCC 9-301(3) . . . clearly provides otherwise by defining the bankruptcy trustee as a 'lien creditor' who primes an unperfected security interest."112 The court then stated: "The trustee is vested with all the debtor's property rights, title and interests. § 541(c)(1). [sic - 541(a)]. That status and that title, coupled with UCC § 2-326(3), clearly subjects plaintiff's property to the trustee's claim."113

In other words, the court seemingly concluded the debtor/consignee had property rights in the consigned goods at the time he filed his bankruptcy petition. Consequently, the goods passed to the estate via Section 541(a) at the time of the petition. The court relied on Section 2-326 to establish that the consigned goods were property of the estate and, hence

110 *Id.* at 84.
111 *Id.* at 85.
112 *Id.*
113 *Id.*
available to the debtor's unsecured creditors.

A "property of the estate" analysis also seems flawed. As a matter of contract between a consignee and true consignor, the consignee has no rights, title or interest in the consigned goods beyond a mere possessory interest. Bankruptcy does not change that nor does state law override it. In fact, Section 2-326 says nothing about the relationship between the consignor and consignee and who has what rights. Presumably, that is a matter left to the parties and their contract. Section 2-326 carefully limits its fiction. If the transaction falls under Section 2-326, then, "with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return."\(^{114}\)

In relying on Section 2-326 to conclude the consigned goods were property of the estate, Judge Britton apparently extended Section 2-326's sales fiction. He must have assumed a non-publicized consignment transaction was to be treated as a sale for all purposes and with respect to all parties. If the sales fiction applied across the board, the debtor would be a buyer of the goods and, therefore, their owner. The consignor would be a seller who had sold goods on unsecured credit. Because the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case,"\(^ {115}\) goods which a debtor has bought and owns become property of the estate. Judge Britton's analysis and conclusions would be unassailable if Section 2-326 established that the non-publicized consignment is to be treated as a sale for all purposes. However, Section 2-326 does not say that.

Does some other state law provision create sufficient rights in the debtor that consigned goods could become property of the estate by operation of Section 541(a)? We know that under Article 9, a consignee/debtor somehow has a "sufficient interest" in the consigned goods to allow his secured party to acquire a security interest in them. Would the debtor's "power" to create a security interest at state law be a sufficient interest in the consigned goods to cause the goods to become property of the estate?

Although anything is possible, especially in this area, the proposition seems dubious. Recognizing a "power" in the debtor to create a security interest seems inherently different from recognizing that the debtor has a "property interest" in the goods. The U.C.C. seems to support such a distinction. Section 9-114 speaks in terms of a secured creditor having a perfected security interest in the goods as if they were the property of the estate.


Section 9-114's language suggests that consigned goods are *not* the consignee's property and hence, the consignee does not have a property interest in them.

Bankruptcy nowhere authorizes the court to improve on or improvise with this state law fiction. As between the consignor and the consignee under state law, the consignor retains title to the goods. The consignee's interest in the goods is limited to a possessory interest. Therefore, when the consignee files for bankruptcy, the consigned goods do not become property of the estate by operation of Section 541(a), although the debtor's possessory interest subjects them to the jurisdiction of the bankruptcy court.

A "property of the estate" analysis does have one advantage. If the transaction is viewed as a sale, the consignor is a seller of those goods. As a seller, it holds an unsecured claim for the purchase price of the goods . . . an unsecured claim on a par with all other unsecured creditors.

*In re Brusich & St. Pedro Jewelers, Inc.* is another case which also employed a form of "property of the estate" analysis. North Star Diamond Company had delivered eight pieces of jewelry to the debtor "on memorandum." The debtor filed bankruptcy. North Star, the consignor, petitioned for relief from the stay, alleging that the debtor lacked title and ownership to the eight pieces of jewelry. It sought a turnover order from the trustee.

In discussing the bankruptcy treatment of a "consignment sale," the court articulated the issue as whether goods consigned to a debtor by a creditor, for which the creditor expressly reserved title to the goods, were property of the estate. The court noted that a debtor's interests in property are governed by state law. The court stated that a consignee under a true consignment was not a buyer within the purview of Section 2-326. The question then became whether the consignee would be deemed, statutorily, to be a "buyer." The court concluded that title to the goods *vested* in the debtor consignee for purposes of a contest between the debtor's creditors and the plaintiff consignor unless the consignor had complied with the notice provisions.

The opinion nowhere mentioned Section 544(a) or the trustee's avoidance powers. Although not entirely clear, the court apparently con-
cluded the consignor's failure to give notice made the debtor a "statutory buyer," at least in so far as his creditors were concerned. As a result, the goods became property of the estate when the debtor filed.\footnote{Of late, some courts (in a non-consignment context) have used Section 541 as a quasi-avoidance power. See, e.g., Koch Refining v. Farmers Union Cent. Exchange, Inc., 831 F.2d 1339 (7th Cir. 1987); and In re S.I. Acquisition, Inc., 817 F.2d 1142 (5th Cir. 1987); contra In re Ozark Restaurant Equipment Co., Inc., 816 F.2d 1222 (8th Cir. 1987). In Koch Refining, the court concluded that an alter ego action was property of the debtor corporation. Koch Refining at 1345-46. As such, the cause of action passed to the trustee upon the debtor's filing and to the exclusion of creditors of the debtor corporation. Judge Cudahy disagreed with the majority's conclusion that a debtor corporation can maintain an alter ego action against its principals. Id. at 1354. He ultimately concurred with the majority's holding, however, because "policy considerations favoring vesting the action in the trustee encourage a sufficiently broad construction of Section 541 to empower the trustee to bring an alter ego action." Id. at 1354-55. The court in In re Ozark Restaurant Equipment Co., Inc., 816 F.2d 1222 (8th Cir. 1987) concluded that an alter ego action was personal to the corporation's creditors and hence the cause of action did not become property of the estate upon the corporation's filing. Id. at 1224-26.}

3. **Consignor as Seller under Section 2-326 vis-a-vis Trustee as Lien Creditor Under Section 544(a)**

As noted, applying the Article 9 model to determine the non-publicized consignor's bankruptcy rights does not seem appropriate nor does the "avoidance/priority" mode of analysis fit comfortably. Furthermore, carried to its logical extreme, a "priority" analysis could have the unin-

\footnote{Of late, some courts (in a non-consignment context) have used Section 541 as a quasi-avoidance power. See, e.g., Koch Refining v. Farmers Union Cent. Exchange, Inc., 831 F.2d 1339 (7th Cir. 1987); and In re S.I. Acquisition, Inc., 817 F.2d 1142 (5th Cir. 1987); contra In re Ozark Restaurant Equipment Co., Inc., 816 F.2d 1222 (8th Cir. 1987). In Koch Refining, the court concluded that an alter ego action was property of the debtor corporation. Koch Refining at 1345-46. As such, the cause of action passed to the trustee upon the debtor's filing and to the exclusion of creditors of the debtor corporation. Judge Cudahy disagreed with the majority's conclusion that a debtor corporation can maintain an alter ego action against its principals. Id. at 1354. He ultimately concurred with the majority's holding, however, because "policy considerations favoring vesting the action in the trustee encourage a sufficiently broad construction of Section 541 to empower the trustee to bring an alter ego action." Id. at 1354-55. The court in In re Ozark Restaurant Equipment Co., Inc., 816 F.2d 1222 (8th Cir. 1987) concluded that an alter ego action was personal to the corporation's creditors and hence the cause of action did not become property of the estate upon the corporation's filing. Id. at 1224-26.}

This novel, modern application of Section 541 seems to differ from case law holding that consigned goods are property of the estate. In the consignment area, the courts have concluded that the goods belong to the debtor/consignee or are deemed to belong to the debtor and hence, the goods become property of the estate upon the debtor's filing. These courts are not saying the debtor/consignee has a cause of action against the consignor which the trustee inherits upon the filing. Of course, if one accepts the proposition that a corporation itself can pursue an alter ego action, one can also accept that a consignee has a cause of action against the consignor for the goods, which the consignee's trustee can pursue.

One supposes this modern application of Section 541 reflects a judicial attempt to give effect to the bankruptcy distribution policy of "equality is equity." The Seventh Circuit said as much:

State law permits the alter ego claim to be asserted by the trustee in pursuing all funds available as Section 541 property of the estate. And federal bankruptcy law permits the trustee to recover property on behalf of all creditors for equitable distribution. Furthermore, this logical procedure obviates multiple liability of the debtor to separate creditors and accords with the Bankruptcy Code's ultimate goal of balancing the equities and interests of all affected parties in a bankruptcy case.

Koch Refining v. Farmers Union Cent. Exchange, Inc., 831 F.2d 1339, 1346 (7th Cir. 1987). Absent such an "interpretation," the trustee, and hence, all creditors of the corporate estate, would be shut out from the particular pot of gold lying at the end of the alter ego action rainbow. That is not the case in the consignment arena. Section 541 need not be manipulated to achieve the desired result. Other provisions of the Bankruptcy Code afford a clean, crisp resolution consistent with the goals of both federal bankruptcy and state law.
tended consequence of denying the non-publicized consignor any meaningful rights in bankruptcy. A "property of the estate" analysis has the advantage of according the consignor unsecured claim status on a par with all other unsecured claims. It is flawed, though, because it requires extending the state law fiction. State law simply does not establish that the consignment transaction vests title to the goods in the consignee. Another mode of analysis is possible which is both consistent with state law and fair to the consignor.

We start with the state law premise. Goods delivered under a consignment transaction governed by Section 2-326(3) are deemed to be on "sale or return" with respect to the consignee's creditors while the goods are in the consignee's possession. This means creditors of the consignee can seize consigned goods to satisfy their claims against the consignee. Inferentially, it also means the consignor who fails to comply with Section 2-326's notice provisions is precluded from asserting its ownership claim to the goods. As between the consignor and the levying creditor, the state law "sale or return" fiction does apply. Thus, as between the consignor and a creditor of the consignee, the goods do "belong" to the consignee. They are deemed to be on "sale or return."

Under Section 544(a), the trustee has the rights and powers of a lien creditor. As a lien creditor, the trustee can preclude the consignor from asserting its ownership claim. As against the trustee qua lien creditor, the goods are deemed to have been sold to the consignee debtor. So, as against the trustee/lien creditor, the consignor is an unsecured credit seller. The trustee, by precluding the consignor's assertion of ownership, thereby causes the consigned goods to become property of the estate.

What had been the consignor's property at state law vis-a-vis the debtor/consignee is freed of the consignor's ownership claim in bankruptcy. Through the trustee's deployment of Section 544(a), the goods become property of the estate.\(^\text{126}\) The consignor becomes a creditor holding an unsecured claim.

This use of Section 544(a) has an estoppel effect on the non-publicized consignor. Essentially, the consignor is estopped from asserting its ownership interest in the goods because it failed to publicize it to the det-

\(^\text{126}\) Property of the estate includes "any interest in property that the trustee recovers under Section . . . 550" 11 U.S.C. § 541(a)(3) (1982 & Supp. IV 1986). Section 550 concerns transfers avoided under Section 544. 11 U.S.C. § 550(a) (1982 & Supp. IV 1986). The trustee's use of Section 544 does not involve avoiding a transfer. It involves avoiding an interest, the consignor's ownership interest. The bankruptcy remedial provisions do not seem to provide for this use of Section 544(a). Perhaps that is because no further remedy is necessary if the ownership claim is vitiating.
Consignments in Bankruptcy

riment of the consignee's creditors. Section 2-326 itself has an estoppel flavor. It extends Section 2-403(2), the entrusting provision, another estoppel-flavored provision. Under Section 2-403(2), if, for whatever reason, an owner of goods entrusts them to someone who deals in goods of the kind, that merchant can sell the goods to a buyer in the ordinary course of business free of the owner's ownership claim. The true owner, by entrusting his goods to a merchant (so it is said), is the author of his own demise. By delivering possession of his goods to the merchant, the true owner has given the merchant the appearance of authority to sell, an appearance which could mislead others. If someone is misled and that someone qualifies as a buyer in ordinary course, the true owner cannot successfully assert his ownership claim. He loses his rights to and in the goods.

That same idea seemingly underlies Section 2-326. This section extends the notion of merchant ostensible ownership to creditors of the consignee. The goods are deemed on "sale or return." The consignor is estopped from asserting the goods are his, not the consignee's. Buyers can take the goods free of the consignor's ownership interest under Section 2-403(2). Under Section 2-326, creditors can seize the consigned goods free of the consignor's ownership claim.

In bankruptcy, the trustee can employ Section 544(a) to assert the rights and powers of a lien creditor and thereby estop the consignor from asserting its ownership interest in the goods. In effect, Section 544(a) precludes the true consignor from denying it sold the goods to the consignee.

Both Section 544(a) of the Bankruptcy Code and Section 2-326 of the Uniform Commercial Code are necessary to the above analysis, but the concepts of priority and subordination are not. This approach neither adds to, subtracts from, nor mangles existing law. In fact, the analysis maintains complete harmony between state law and federal bankruptcy law. Finally, it produces the results which courts strive mightily to reach. The unfiled consignor, deemed a seller of the goods, will hold an unsecured claim for their value. The goods themselves will become property of the estate. All is right in both Code worlds.

Although not easily discernible, several courts seem to have been headed in this direction. Relying on both Section 544(a) of the Bankruptcy Code and Section 2-326 of the U.C.C., these courts have articulated the issue as one of priority between the consignor and creditors of the consignee.188

---

In *In re KLP Inc.*, the plaintiff had unquestionably failed to comply with Section 2-326. According to the court, there was only one question: Was the transaction a "consignment sale?" The opinion discussed Section 2-326 observing that it was:

not only one of the more important UCC sections but also one of the most unique provisions... which governs the sale of goods. *The uniqueness... lies primarily in the fact that the section applies to transactions which are not true sales at all, since the section governs agreements which somehow provide that delivered goods may be returned by the buyer even though they conform to the contract.* The section's importance lies primarily in the role it plays, along with the notice provisions of Article 9, in giving disclosed claims to property priority over secret claims. To encourage disclosure of *in rem* claims is a central feature of any well-reasoned system of commercial law.

The court noted the trustee had the status of an execution creditor under Section 544. It further noted the goods were subject to the consignee's creditors' claims under state law. The court stated: "[t]he consignment seller may obtain priority over the consignment buyer's creditors only by complying with the notice requirements of UCC § 2-326(3)." Because the consignor had not complied with the notice provisions of state law, the court denied the consignor's turnover order.

Although the court discussed the issue in terms of priority and it failed to make all the necessary connections between state and bankruptcy law, it was on the right track. It might have added: "The consignor's turnover order is denied because the transaction is deemed a sale as against the bankruptcy trustee. At state law, the consignor would be precluded from asserting its ownership claim as against a lien creditor. As a result, in bankruptcy, the consignor's ownership claim is ineffective against the bankruptcy trustee."

This use of Section 544(a) does not "avoid" a debtor transfer or obligation. It therefore differs significantly from the trustee's usual deploy-
ment of the "strong-arm" clause to slay unperfected security interests. The latter clearly does involve avoidance of a debtor transfer — the debtor's giving of a security interest. In the consignment context, the trustee need only assert a lien creditor's state law rights and powers to deny the consignor's ownership claim. This use of Section 544, "assertion of creditor rights," like its "avoidance" use, has the effect of creating property for the estate.

1989 Bankr. 627 (Bankr. S.D. Ohio 1982). The court noted that, under a true consignment, a consignee was not a buyer. It suggested that the question was whether the consignee was "statutorily deemed a 'buyer,' thereby triggering the creditor rights asserted by the trustee." Id. at 630. The court also stated:

"The specific legal question... is whether the relationship between plaintiff, as consignor, and defendant, as consignee, constitutes a consignment sale... If determined to be a consignment sale under [2-326(3)], then title to the diamond is vested in Debtor-consignee for purposes of a contest for the diamond between Debtor's creditors and plaintiff-consignor, unless compliance with [§ 2-326] is substantiated." Id. at 629-30 (emphasis added).

This analysis was close but still missed the mark. It is not necessary to conclude a consignee debtor has vested rights in consigned goods. It is possible to conclude the debtor has no rights in them and yet still conclude that the goods become property of the estate because, as between the consignor and the trustee qua lien creditor, the transaction was deemed a sale.

In Roudebush, the consignor prevailed. No doubt the facts influenced the result. The consignor was the mother of the consignee. The item consigned was the diamond ring the consignor had purchased for her husband, now deceased. The son apparently conducted much of his business at cocktail parties. He did not have an established place of business at the time of the consignment and the court therefore concluded that Section 2-326(3) did not apply. As a result, the common law of agency applied and Mom got back her ring. Id. at 631.

Another case contained the seeds of this analysis. In In re Brusich & St. Pedro Jewelers, Inc., 28 Bankr. 545 (Bankr. E.D. Pa. 1983) the court phrased the issue as whether goods consigned to a debtor by a creditor, where the creditor expressly reserved title to the goods, was property of the estate.

North Star Diamond Company had delivered eight pieces of jewelry to the debtor "on memorandum." The debtor filed bankruptcy. North Star petitioned for relief from the stay alleging that the debtor lacked title and ownership to the eight pieces of jewelry. It sought a turnover order from the trustee. Id. at 546.

The court noted the debtor's interests in property were governed by state law. Id. at 547. The court, relying on other case law, stated a consignee under a true consignment is not a buyer within the purview of Section 2-326. However, the question then becomes whether the consignee is statutorily deemed a "buyer." Id. The court ultimately concluded title to the goods vests in the debtor consignee for purposes of a contest between the debtor's creditors and the plaintiff consignor unless the consignor complies with the notice provisions. Id. at 548.

The opinion nowhere mentioned Section 544(a). Although it is not clear, the court may have concluded the consignor's failure to give notice made the debtor a statutory buyer and hence, the goods became property of the estate under Section 541 as of the filing.

David G. Epstein, Dean of Emory Law School, in commenting on a draft of this article, asked me to consider other possible situations in which the trustee might assert Section 544(a)'s "rights and status of a lien creditor" aspect rather than its "avoiding" aspect. For instance, consider a
4. The Bankruptcy Contest Between the Article 9 Secured Party and the Consignor

Courts feel very comfortable analyzing priority between a perfected secured party and a consignor in the bankruptcy context. As a result, the reader who ventures forth into this strand of the consignment case law feels comfortable as well. For the most part, the results track the expected state law result. The consignor whose transaction falls within Section 2-326(3), who does not comply with its notice provisions, or who complies

buyer of accounts who has failed to comply with the Article 9 formalities. Under Section 544(a), the trustee would avoid the buyer's ownership interest in the accounts purchased. However, the trustee would also be avoiding a transfer from the debtor-seller to the buyer. This differs from the consignment situation. In a consignment transaction, the debtor has not transferred anything or incurred any obligation. As a result, there is no debtor transfer or obligation for the trustee to avoid under the "strong-arm" clause. Logically then, the trustee cannot apply the "avoidance" aspect of Section 544(a) to determine the consignor's rights in bankruptcy.

Although the trustee's assertion of the rights of a lien creditor precludes the consignor's ownership claim and this is a form of avoidance, avoidance of an ownership claim, it does not also involve avoiding a debtor transfer or obligation.

So, too, the buyer in a bulk sale who fails to comply with bulk sales law loses his ownership claim to the trustee under Section 544(a). But once again, avoidance of the buyer's ownership claim goes hand in hand with avoiding the debtor's transfer/sale of his assets.

The closest parallel to the consignment situation is the seller who retains possession of sold goods. Section 2-402 of the Uniform Commercial Code addresses a seller's fraudulent retention of possession of sold goods. As one court noted, "[u]nder Pennsylvania law, it has been uniformly held that a transfer of property from a seller to a buyer will constitute, as to the seller's creditors, a legal fraud, unless there is an adequate change of possession in the form of actual or constructive delivery." Proyectos Electronics, S.A. v. Alper, (In re Proyectos Electronics) 37 Bankr. 931, 933 (E.D. Pa. 1983). If the court deems the sale fraudulent as to the seller's creditors, the court can void the sale. The trustee, as "super" lien creditor, could do so as well. Id. at 933. Once again, however, in avoiding the buyer's ownership claim, the trustee would also be avoiding a debtor transfer - a transfer of ownership from the seller/debtor to the buyer. The trustee's assertion, under Section 544(a), of the rights and powers of a lien creditor seems sui generis to ownership claims. It is not limited to consignors however. The trustee's lien creditor rights can fell other owners as well.

In In re Black & White Cattle Co., 30 Bankr. 508 (BAP, 9th Cir. 1983), an owner delivered 3,500 heifers and 57 bulls to debtor's feedlot for care and feeding. California required owners who delivered cattle into the possession of a feedlot operator to publicly record the feeding agreement. The owner did not give the requisite notice. In the feedlot operator's subsequent bankruptcy, the trustee avoided the owner's ownership claim under Section 544(a).

In In re Purity Ice Cream Co., Inc., 90 Bankr. 183 (Bankr. D.S.C. 1988), a true lessor of ice cream processing equipment moved for relief from the automatic stay. The DIP/lessee argued the true lessor's failure to file a UCC-1 financing statement as required by South Carolina law "subordinated" the lessor's claim to that of the debtor under Section 544. The court "rescued" the lessor's ownership claim from DIP annihilation by enforcing the parties' agreement regarding choice of law. Had the court chosen the apply South Carolina law, the plaintiff-lessee would have lost its ownership claim to the leased equipment under 544(a).

Beyond ownership interests, all other Section 544(a) situations seem to involve avoiding a debtor transfer or obligation.
with the filing requirements but fails to give notice to the filed inventory financier, usually loses to the secured party. Typically, the estate gains nothing.

In one case, the trustee managed to prevail over both the non-publicized consignor and the secured party. The court concluded that regardless of whether the consignment was governed by Article 9 or Article 2, the consignor lost because it did not comply with the notice provisions. In addition, the secured party had no claim to the consigned goods because the security agreement limited its security interest to goods owned by the debtor.

The case may be an example of what happens when a court refuses to apply legal fiction to reality. Certainly another conclusion was possible. Section 2-326 deems the goods to be owned by the debtor vis-a-vis his creditors. Section 9-114 recognizes a security interest in goods not really owned by the consignee, but fictionally owned, at least in so far as creditors are concerned. The court could have indulged in the state law fictions to conclude that the debtor owned the goods and, hence, the secured creditor had an interest. On the other hand, the court's refusal to indulge in the Article 2 fiction caused the estate to benefit.

As this section began, so it ends. Diamond, Inc. can expect to be dispossessed of its ownership claim to the diamonds in Rodney's possession. The manner in which the court will defrock Diamond, Inc. is anybody's guess.

B. Goods Not in the Possession of the Consignee at the Time of the Petition But Returned or Taken Within Ninety Days Preceding Bankruptcy

In our hypothetical, Rodney returned several parcels of diamonds to

131 See, e.g., In re State St. Auto Sales Inc., 81 Bankr. 215 (Bankr. D. Mass. 1988) (consignor who does not comply has an interest junior to secured creditor and this is so even if secured creditor has knowledge because prescribed notice is more important than knowledge itself); In re Great American Veal, Inc., 59 Bankr. 27 (Bankr. D.N.J. 1985) (consignor never perfected, therefore goods are available to secured creditor); In re Lebus-Albrecht Lumber Co., 38 Bankr. 58 (Bankr. D.N.D. 1984) (consignor filed but could not prove it mailed notice to creditor, therefore its interest was subordinate).


133 Id. at 398.

134 Id.

135 In In re Ide Jewelry Co., 75 Bankr. 969 (Bankr. S.D.N.Y. 1987), the consignor's insurance company sought to recover insurance proceeds from the consignee's bankruptcy trustee. The consignee's insurance policy only covered goods owned by someone other than the consignee. The court concluded that Section 2-326 established the consignor did not own them. The court obviously thought the Article 2 fiction applied to the consignor-consignee relationship.
Diamond, Inc. during the ninety days preceding his petition for bankruptcy relief. Under state law, a return of consigned goods to the consignor seems to mark the end of the danger zone and the establishment of “home free” status. According to Section 2-326(2), the state law fiction only lasts while, and presumably as long as, the goods remain in the consignee’s possession. Although Diamond, Inc. may well be “home free” at state law, its situation in bankruptcy is another matter. Most courts have concluded that a return of consigned goods during the ninety days preceding bankruptcy constitutes a Section 547(b) preference. This may come as surprising news to some.187

If we analyze the consignment transaction in its “pure form,” that is, before either Code “gets its hands on it,” it seems difficult to make a return of consigned goods meet the statutory requirements for a preferential transfer. The technical problems begin with finding the requisite transfer of an interest of the debtor in property.188 In a true consignment, title does not pass from consignor to consignee. At most, the consignee has a possessory interest in the consigned goods. If and when the consignee returns consigned goods to the consignor, can THAT constitute a transfer of an interest of the debtor in property? A return of bailed goods during the ninety-day window is not a preferential transfer.189


187 Precedent for finding a preferential transfer pre-dates either Code. In Virginia Book Co. v. Sites, (In re Magee) 254 F.2d 46 (4th Cir. 1918), the court concluded that a consignor who failed to comply with the state sign statute received a preference when he repossessed goods.


189 In true bailment situations, a return of goods, no matter when it occurs, does not constitute a preference. See, e.g., In re Fuel Oil Supply & Terminaling Inc., 72 Bankr. 752 (S.D. Tex. 1987), rev’d on other grounds, 837 F.2d 224 (5th Cir. 1988); In re Crouthamel Potato Chip Co., 6 Bankr. 501 (Bankr. E.D. Pa. 1980). If goods are in the bailee’s possession when he files bankruptcy, the bailor has a right to their return. In re MCZ Inc., 82 Bankr. 40 (Bankr. S.D. Tex. 1987).

In re Fuel Oil Supply provides an interesting contrast to the consignor’s situation in bankruptcy. It involved a “loan or exchange” agreement of gasoline under which Gulf was to deliver to Fosti 200,030 barrels of gasoline at the end of July and Fosti was to “redeliver” the same amount of gasoline by the end of August. The district court, reversing the bankruptcy court, held that “[t]he agreement between Fosti and Gulf was a bailment. A transfer of property required from a bailee to a bailor is not a preference and is not a payment on a debt. . . . If title was intended to be transferred, the exchange is a sale. If no transfer of title was intended, then a bailment occurred.” 72 Bankr. at 758.

The contract in question provided that title would pass at a certain delivery point. The district court described it as merely a means of allocating the risk of loss. Id. at 759.

The Fifth Circuit did not discuss the issue. It concluded all the transactions were shielded from preference attack as contemporaneous exchanges under Section 547(c)(1). 837 F.2d at 229-31.
Consignments in Bankruptcy

Other “minor” problems exist. Section 547(b) requires a transfer for the benefit of a CREDITOR. Ignoring, for a moment, the Bankruptcy Code’s definition of “creditor,” intuitively, the consignor does not seem to be a creditor because the consignee does not owe anything to the consignor. A consignment transaction is NOT a sale. According to the very essence of a consignment transaction, the consignee does not obligate itself to buy the consigned goods. There is no purchase price. If the consignee does not owe the consignor anything, the consignee cannot be a debtor. If the consignee is not a debtor, it seems difficult to conclude the consignor is a creditor. Consequently, it becomes difficult to locate the antecedent debt which Section 547(b) requires. If the consignment transaction does not involve a creditor, a debtor, a debt, OR a transfer of an interest in the debtor’s property, exactly WHERE or HOW do courts find a preference?

As every school child also knows, intuition and logic are not necessarily synonymous with the Bankruptcy Code. Indeed, under the Bankruptcy Code’s definition of claim, a consignor could conceivably be a creditor. Arguably, the consignor has a right to an equitable remedy for breach of performance — that is, a right to the return of its consigned goods. However, broadly read, the lessor and the bailor would also be creditors. Their right to THEIR goods could be reduced to a claim for

Other mysterious things are happening in bankruptcy land. The Ninth Circuit recently concluded that rescission of an executory contract during the ninety day vulnerability period and the buyer’s return of all purchased goods in exchange for cancellation of the indebtedness was NOT a preference. Because the contract was an executory contract, a return of the goods upon cancellation was not a preference. In re Wegner, 839 F.2d 533 (9th Cir. 1988).

On remand, the bankruptcy judge muttered a bit that the transaction satisfied each and every preference element. In re Wegner, 83 Bankr. 750, 752 (Bankr. D. Mont. 1988). The Ninth Circuit’s reasoning escapes me as well.


142 Only two courts have been stymied by the antecedent debt requirement. See In re Marta Group, Inc., 33 Bankr. 634 (Bankr. E.D. Pa. 1983) (no preference because antecedent debt not present); In re Reinard, Inc., 1 U.C.C. Rep. Serv. 424 (Bankr. W.D. Pa. 1961) (no preference because no payment for or on account of an antecedent debt).

Another court gave up the ghost only because the trustee had not proved the debtor’s insolvency at the time of the transfer. In re Phippens, 4 Bankr. 155 (Bankr. M.D. Tenn. 1980).


money. Neither the Bankruptcy Code nor the case law support such treatment for lessors and bailors. Furthermore, Congress' definition of "claim" seems to be an attempt to capture a party's right to seek specific performance of contract rights because money damages will be inadequate to compensate the aggrieved party. Lessors, bailors and consignors do not need to seek equitable relief to protect their right to and rights in property. For purposes of this article, the Bankruptcy Code's definition of "creditor" does not automatically include the consignor.

If we view the return of consigned goods, free from all statutory technicalities, clearly, a return of consigned goods during the preference period could represent the very kind of pre-bankruptcy activity which Section 547 was designed to discourage. Certainly, a consignor's self-help removal of consigned goods because a consignee has not paid his debts looks like a preference. On the other hand, if the goods do not belong to the consignee, can we meaningfully say the activity harms the debtor's creditors, or that the debtor is preferring one "creditor" over his other creditors?

Several courts have glided over, or slipped and sloshed through Section 547, to find a voidable transfer. One court plausibly concluded that the return of greetings cards was a Section 547(b) preference, but the trustee could not recover the cards or their value because the return constituted a payment in the ordinary course under Section 547(c)(2).

Sometimes, the facts lend themselves to a conclusion that the transaction is a security consignment. In such cases, finding a preference is

---

146 Section 365 dealing with executory contracts recognizes and deals with the lessor's right to his goods or real property. 11 U.S.C. § 365 (1986). The lessor is not just a creditor.

147 The case law recognizes the bailor's right to receive his goods. The courts do not view the bailor as just another creditor, despite the seemingly broad definition. See, e.g., In re Fuel Oil Supply & Terminaling Inc., 72 Bankr. 752 (S.D. Tex. 1987), aff'd on other grounds, 837 F.2d 224 (5th Cir. 1988) (because of bailment relationship, product transfers were not preferential transfers); In re Crouthamel Potato Chip Co., 6 Bankr. 501 (Bankr. E.D. Pa. 1980) (absent state enactment otherwise, if property is in bankrupt's hands as bailee or agent, the trustee holds it as such and the bailor can recover the property or its proceeds); and Cattle Owners Corp. v. Arkin, 252 F. Supp. 34 (S.D. Iowa 1966) (bailment relationship without more does not give bailee interest in bailor's property).


relatively easy. *In re Denmark* is a good example. The Chapter 7 trustee brought an action against a gasoline supplier to recover the value of gasoline he had taken from the debtor’s place of business approximately three weeks prior to the debtor’s filing. The supplier had removed 8,125 gallons of gasoline from underground tanks at the debtor’s place of business. At the time, the debtor owed the supplier $13,228. Upon leaving the debtor’s place of business (at 3:00 a.m., having arrived at 1:00 a.m.), the supplier left a credit invoice which credited the value of the gasoline taken toward the debtor’s outstanding indebtedness. On those facts, it was not difficult to meet the statutory requirements of Section 547. Indeed, it took the court less than two pages to conclude that the transaction constituted a preference.

The court noted the defendant was unquestionably a creditor (which, of course, made the debtor “a debtor” for Section 547(b) purposes). The transfer, retaking of the gas, was on account of an antecedent debt (the supplier had credited the amount toward the indebtedness). The assets in the debtor’s bankruptcy were not sufficient to cover priority claims. Therefore, the transfer clearly improved the creditor’s position.

The supplier argued that title to the gasoline never passed to the debtor and, hence, its removal did “not constitute a transfer of an interest of the debtor in property and, therefore, . . . [it was] not recoverable by the trustee as a preference.” The court responded: “State law is dispositive in deciding whether title passed to the debtor under the consignment contract and U.C.C. Section 2-326 is controlling in this instance.” It then quoted Section 2-326(3) in full and noted the supplier had not complied with its notice provisions. The court concluded by noting the defendant had failed to carry the burden of establishing its affirmative defense.

Reading between the lines, the court apparently assumed the supplier’s failure to prove compliance with the notice provisions meant that title had passed from consignor to consignee. Consequently, the consignee had an interest in the gasoline at the time the goods were retaken and thus, there was a transfer of an interest of the debtor. State law, of course, does not establish that title passes from consignor to consignee. State law says nothing about the relationship between the two parties to the con-

---

(D.N.J. 1971); and *In re Denmark Co.*, 73 Bankr. 325 (Bankr. S.D. Fla. 1987).

139 *Id.* at 326.
140 *Id.* at 327.
141 *Id.*
assignment contract. State law concerns itself only with the ability of creditors of the consignee to reach goods in the consignee's possession. As to them, the transaction is deemed a sale for the limited purpose of allowing them to reach the property.

State law limits its "sale or return" fiction in terms of time as well as in terms of effect. Is it legitimate to invoke the state law fiction for preference purposes or has the state law sale fiction come and gone with respect to goods returned before bankruptcy? Preference law focuses on the time of the transfer. At the moment preceding the transfer, the state law fiction continues. At that moment, and as against creditors of the consignee, the goods are deemed on "sale or return." Consequently, the court's reliance on the state law fiction is not troubling in terms of time. Rather, it is the court's extension of the "sale or return" fiction to the consignor-consignee relationship which is troubling. Having "established" that state law dis-positively vested title in the consignee, the remaining preference elements just fell into place.166

A 1986 case, In re Castle Tire Center, Inc.,167 involved a consignee's voluntary return of consigned tires to the consignor within the ninety-day period preceding bankruptcy. According to the court, no one could dispute that a transfer (as in "physical transfer") from debtor to the consignor had occurred.168 The consignor argued no preferential transfer occurred because the transfer in question did not involve property in which the debtor had an interest.169 The court gave two responses. It quoted Collier to the effect that an interest in property under the Bankruptcy Code includes "anything of value which has debt-paying or debt-securing value."170 Secondly, under state law,

all reasonable doubts regarding the nature of the transaction are to be re-solved in favor of the Debtor's general creditors . . . . In addition, reservations of title in consignment agreements do not control the rights of general creditors in situations such as the one at hand when Debtor, at its place of

166 In a fairly old preference case, the Eighth Circuit did a rather glib analysis on similar facts. Mann v. Clark Oil & Refining Corp., 302 F. Supp. 1376 (E.D. Mo. 1969), aff'd, 425 F.2d 736 (8th Cir. 1970) (per curiam). The court characterized the transaction as a security consignment but noted that even if it were a true consignment, a preference had occurred. Section 2-326 governed and no notice had been given. The goods were subject to the claims of the bankrupt's creditors.

168 Id. at 182.
169 Id. at 183.
170 Id.
business, deals in goods of the kind involved.\textsuperscript{161}

The court's reference to "resolving all reasonable doubts regarding the transaction in favor of the debtor's general creditors" seems to be a non-sequitur. The issue was whether the debtor had an interest in the property. Even if, as between the consignor and creditors of the consignee, the transaction is deemed a sale, does that create an interest of the debtor in the property? Was this court also saying a "sale or return" transaction means the debtor acquires title to the goods? Because the court found all the requirements posited by Section 547(b), it found a preference. The court concluded: "Butler [the consignor] cannot be permitted to defeat both the purposes of the Bankruptcy Code and the Pennsylvania Uniform Commercial Code."

Perhaps this opinion stands for the proposition that a return of consigned goods falls within the policy of Section 547 although not within its letter. The court drew on state law for the precept that creditors were to be protected. Obviously, this midnight transfer harmed other creditors of the debtor. Therefore, the transfer was not allowed to stand.

However, the transaction does not seem to meet the statutory requirements of Section 547, even as interpreted under Section 2-326. Only the debtor/consignee's creditors have an interest in the goods. Section 547 does not speak in terms of the interests of creditors, but rather in terms of an interest of the \textit{debtor}.

In \textit{Castle Tire}, the trustee only sought to recover an amount representing the value of merchandise delivered to the debtor more than forty-five days before the repossession.\textsuperscript{168} This suggests the trustee assumed the "ordinary course" exception would shield goods delivered and returned within a forty-five day cycle. \textit{Windsor Communications Group v. Freedom Greeting Card Co.}\textsuperscript{164} explicitly discussed the application of Section 547(c)(2)'s "ordinary course" exception to the consignment transaction. Anyone who assumed Section 547(c)(2)'s "ordinary course payment" exception only applied to transfers of money needs to read this case. It makes a transfer of goods a perfectly plausible (maddeningly so) payment. The court alternatively described the transactions between supplier and retailer as a "consignment sale agreement,"\textsuperscript{165} and as "sales agree-

\textsuperscript{161} \textit{Id.}
\textsuperscript{168} \textit{Id.} at 184.
\textsuperscript{169} \textit{Id.} at 181.
\textsuperscript{164} 63 Bankr. 770 (E.D. Pa. 1986).
\textsuperscript{165} \textit{Id.} at 772.
ments.” All the agreements contained an option to return. As the court noted, “Windsor (the retailer) had the option of paying for the full shipment or returning the unsold portion for a credit.” Although the supplier issued an invoice with each delivery, the court described it as a “pro forma invoice” and payment was not due immediately. This description of the facts suggests a true “sale or return,” and not a consignment transaction at all.

The bankruptcy court held that the return of the cards was a preferential transfer. In the bankruptcy court proceeding, the parties most strenuously litigated the issue of whether the returned cards belonged to the debtor and, hence, whether they were property of the debtor. The bankruptcy court decided the debtor did have an interest in the cards at the time he returned them. The district court spent little time evaluating the existence of a preferential transfer. Instead, it embarked on a lengthy analysis to conclude the return constituted a payment in ordinary course and hence, the supplier was not liable for the value of the returned cards. Because the supplier credited the value of all returned cards to the retailer’s debt, the return of the cards did constitute a “payment” of sorts. According to the court, “the transfer, made pursuant to an ongoing business relationship, was thus payment of an ordinary debt. . . .”

To bolster its conclusion, the court relied on Section 547(c)(2)’s underlying policy “to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor’s slide into bankruptcy.” Later, the court observed that “[t]he option to return was not a device thought up to avoid the perils of bankruptcy, but a bargained-for element of the parties’ customary business relationship.”

If preference law is to apply to true but unpublicized consignment transactions, and the alternative, invocation of fraudulent conveyance law, is considerably worse from the perspective of consignors, surely this court’s analysis stands as a hallmark of sanity and common sense. It may

---

166 Id.
167 Id.
168 Id.
169 Id. at 773.
170 Id.
171 Id. at 774.
172 Id.
173 Id. at 775.
torture the concept of “payment,” but in light of the rampant torturing and reconstruction which already pervades the consignment area, surely it can be tolerated in defense of the transaction.

*In re Lebus-Albrecht Lumber Co.*\(^{174}\) provides another unusual twist to this puzzle. It indicates, by negative inference, that preference attacks may not be as misguided as one might otherwise suppose. The bankruptcy trustee sought to avoid the debtor’s transfer of certain inventory items back to the consignor. For a refreshing change of pace, this time the consignor *had* filed an Article 9 financing statement. Unfortunately, he had not given notice to the prior filed inventory financer in accordance with Section 9-114. The court “articulated” the preference issue as “whether the Trustee’s interest in the property is superior to that of Minot’s [the consignor], thereby giving him the power to avoid the transfer under section 547 of the Bankruptcy Code.”\(^{178}\) It then noted: “Section 547, however, must be considered in conjunction with the strong arm power of section 544.”\(^{176}\)

At first blush, both statements make NO sense at all. When does the trustee ever need a superior interest to lodge a preference attack? In addition, when do courts consider Section 544 to decide whether a preference has occurred? Preference challenges against an Article 9 secured party do not involve such considerations, so why should a consignment transaction? Like most other cases in this area, the court’s discussion was strange and confusing. Paraphrasing would not do justice to this delphic opinion:

As an unsecured creditor, the Trustee must have the right . . . to avoid the transfer to Minot. . . . If the Trustee here is to have rights paramount to Minot, such rights would have to be premised upon the unperfected status of Minot’s consignment. As an unsecured creditor, the Trustee’s rights in consigned goods are defined by section 2-326 rather than section 9-114 which only subordinates the perfected consignment to a prior perfected security interest. If the Trustee is to have standing to avoid the transfer, the consignment by Minot to Riverside must fail to meet all of the elements of section 2-326(3). It did not. . . . Minot’s financing statement was in compliance with section 9-402 and hence with section 2-326(3)(c), the effect of which was to perfect its interest in the goods, such interest becoming paramount to a lien creditor, which includes the Trustee. Therefore, the interest of the . . . Trustee in the goods . . . was inferior to the interest of Defend-


\(^{175}\) Id. at 62.

\(^{176}\) Id.
The Trustee, being inferior to Minot, may not use his section 547 powers to recover the property or its value from Minot, irrespective of whether the elements of section 547 have been met.\textsuperscript{177}

I think the court was driving at, aiming toward, or in the approximate vicinity of, the following proposition. If the consignor’s ownership interest can withstand strong-arm assault, that means bankruptcy recognizes the consignor’s ownership claim. If bankruptcy recognizes the consignor’s ownership claim, then the consignee did not have an interest in the goods such that his return of the goods constituted the requisite transfer under Section 547(b). Certainly that reasoning is logical. It is a complicated way of concluding that a return of bailed goods cannot constitute a preference. (The case law discussion of consignment transactions is so confused and confusing that complex ways to arrive at simple propositions is the norm rather than the exception.) Presumably, the court concluded that the consignor’s Article 9 filing preserved his ownership claim at state law and therefore, preserved it against the bankruptcy trustee. As a consequence, it precluded a preference attack.

A 1971 New Jersey district court opinion, \textit{In re Gross Mfg. & Importing Co.},\textsuperscript{178} provides a sophisticated and thoughtful preference analysis. Having discussed both the application and policy of the state law approach,\textsuperscript{179} the court concluded goods in the possession of a consignee are subject to the claims of the consignee’s creditors.\textsuperscript{180} Where most opinions would end, this one had really just begun: “However, that is only part of the greater issue raised by this case. That issue is: Assuming a valid but unfiled consignment, does the return of the goods delivered pursuant to that agreement, which by law are on ‘sale or return’... constitute a voidable preference?”\textsuperscript{181}

The court used an Article 9 analysis as its reference point. A late filing within the preference period would obviously constitute a preference if made by an Article 9 secured party. A late filing by the consignor should as well. If so, a retaking of the goods during the relevant period should also constitute a preference. Repossession is simply another form of perfection: “[i]f one method of late perfection (e.g. filing) constitutes a voidable preference, logic dictates that late perfection by repossession . . .

\textsuperscript{177} \textit{Id.} at 63.
\textsuperscript{178} 328 F. Supp. 905 (D.N.J. 1971).
\textsuperscript{179} \textit{Id.} at 909.
\textsuperscript{180} \textit{Id.} at 910.
\textsuperscript{181} \textit{Id.}
would likewise have the same effect."

The court, however, seemed troubled because it did not rest on its laurels or on its conclusion that a return of goods, like a late filing, establishes the requisite Section 547(b) transfer. It quoted the Bankruptcy Act definitions of "preference" and "transfer," and then stated: "The return of goods which were subject to creditors' claims while in the debtor's possession was a 'disposing of or parting with . . . the possession thereof' as well as the 'power to transfer' them . . . . This § 60(a) 'transfer' was for the benefit of a 'creditor'. . . ."

This court, unlike others, attempted (albeit obliquely) to connect federal preference law and its creditor protection policies with the state law treatment of consignments which also seeks to protect creditors. Indeed, if we view Section 547 as phasing in federal bankruptcy policy at ninety days preceding bankruptcy, and the goods are in the consignee's possession at that time, bankruptcy preference law may simply be carrying on the thought that state law began.

In a very real sense, Section 547 is an "estate forming" provision. It attempts to insure the existence of an estate at the time the debtor files. Because Section 547 protects the estate from dissipation by allowing the trustee to recover dissipating transfers, it protects creditors of the estate. That process begins ninety days before bankruptcy. Transfers which deplete the estate, and which are not protected for one policy reason or another, are recoverable in bankruptcy.

The bankruptcy estate exists for a debtor's unsecured creditors. At the ninetieth day preceding bankruptcy, state law establishes that goods in the consignee/debtor's possession under a non-publicized consignment are available to the debtor's creditors. A return of those goods during the ninety day period would be a transfer of property otherwise available to the general creditors. It would involve a transfer of property which would have been property of the estate but for the transfer. The transfer would deplete the "estate to be," and would thus be detrimental to the debtor's unsecured creditors. A policy-based interpretation of the "transfer" language of Section 547(b) would capture transfers of property that would have become property of the estate; e.g., transfers of property that would otherwise be available to the consignee's unsecured creditors. So

\[182\] Id. at 911.
\[183\] Id.
\[184\] Id.
\[185\] Id.
interpreted, a return of consigned goods would constitute a voidable transfer. (Congress, of course, could not draft Section 547 that way. The estate only comes into existence when the bankruptcy petition is filed. Consequently, transfers of property of the estate during the ninety days preceding the estate's legal existence are literally impossible.)

Interpreting Section 547 to allow recapture of transfers of property that would have become property of the estate but for the transfer obviously involves further "imaginative" manipulation. It does not involve a great leap in logic or policy. Most debtor transfers of interests in property involve property which would have been property of the estate but for the transfer, that is, they involve transfers of property which would have been otherwise available to creditors but for the transfer. When the transfer is unraveled, the property does become property of the estate and available for creditors. If we view both preference law and the state law treatment of non-publicized consignments as being creditor-protective laws, the state law approach and the federal bankruptcy approach work hand in hand to bring the goods back into the estate.

If the transfer hurdle is overcome, the other requirements of preference law are easily satisfied by relying on the state law construct at the time of the transaction. At the time of the transfer, the transaction is deemed a "sale or return" as against the debtor's creditors. As a sale, there must be a debt and when there is a debt, a debtor and a creditor cannot be too far behind. The improvement in position test is easily satisfied if the unfiled consignor is deemed an unsecured credit seller.

Although the policy seems to fit the crime, the technical statutory requirements of Section 547(b) do not. This explains why courts build on state law, federal law, policy and/or their own imaginations to reach their results. Although the straining and importing of concepts may be troublesome in the abstract, and certainly mystifying to the reader on most occasions, the results courts reach are not particularly objectionable.

Furthermore, a rejection of the legal "hocus pocus" necessary to find a preference openly invites application of fraudulent conveyance law to the non-publicized consignment transaction. If fraudulent conveyance law governs the consignor's rights, a far worse and arguably unfair bankruptcy fate awaits the non-publicized consignor.

The state law fiction was created as a result of concern for protecting third parties who might be misled by the debtor's ostensible ownership of goods. The state law approach is simply a modern solution to concerns
voiced as early as 1601 in *Twyne's case.*\(^{186}\) A debtor's possession of goods without title has overtones of fraud. Even if the transaction is squeaky clean, a transfer by the debtor without receiving reasonably equivalent value in exchange is still an avoidable transfer under Section 548(a)(2) of the Bankruptcy Code.

Using fraudulent conveyance theory to handle the non-publicized consignment transaction would, at a minimum, jeopardize the consignor's position and rights for the year preceding bankruptcy.\(^{187}\) Depending on the applicable state fraudulent conveyance law, the consignor could conceivably be liable for all goods (or their value) returned during the four years preceding bankruptcy.\(^{188}\) The unfiled consignor might unwittingly be forced to make a massive "contribution" to the estate. One suspects application of fraudulent conveyance law would spawn the same kind of playing with mirrors to reach the right result which the present approach has engendered.

Notwithstanding admitted logistical problems, a preference analysis seems better suited to do justice. It has the distinct advantage of limiting the consignor's bankruptcy risk to a return of the goods or their value in the debtor's possession at the ninetieth day before bankruptcy.

Furthermore, as noted above, judicial reliance on preference law offers the possibility that some unfiled consignors may be shielded from ultimate liability. The "ordinary course" exception may protect some returns which reflect ordinary business relations and a prior course of dealing between the parties. In addition, Section 547(c)(4)'s "subsequent advance" or "reimbursement rule" exception would offer protection to the consignor who periodically delivers and retakes goods. To the extent that a return of goods during the ninety days preceding bankruptcy is followed by a new consignment of goods, the previous return of goods could be shielded, to some extent, from preference attack. No such protection exists under fraudulent conveyance law.

Returning to our hypothetical, the case law indicates that Rodney's periodic returns of diamonds during the ninety days preceding bankruptcy would constitute avoidable preferences. The court might decide the state

\(^{186}\) *3 Coke 80*, 70 Eng. Rep. 809 (1601).

\(^{187}\) The trustee's power under Section 548 of the Bankruptcy Code is limited to transfers made or obligations incurred within one year preceding bankruptcy. 11 U.S.C. § 548(a) (1982 & Supp. IV 1986).

\(^{188}\) The trustee can assume the rights and powers of any actual unsecured creditor at state law and avoid any transfer or obligation which that actual, unsecured creditor could avoid. 11 U.S.C. § 544(b) (1982 & Supp. IV 1986).
"sale" label is dispositive and therefore, Rodney had title to the diamonds when he returned them. Alternatively, the court might conclude that anything constitutes a transfer under the Bankruptcy Code. Finally, it might analogize the facts to their probable treatment under Article 9 and hold that repossession is a form of perfection. Thus, if Diamond, Inc. repossessed during the vulnerability period, the requisite transfer would be established. No matter how the court arrives at the end result, the end result seems inexorable. Rodney’s returns will constitute avoidable preferences.

On the encouraging side, Section 547(c) offers Diamond, Inc. two possible rays of hope. Diamond, Inc. could avoid liability by showing that the returns mirrored an established course of business between the two parties. It could also avail itself of the subsequent advance rule to limit its preference liability.

If preference law does not apply because the transfer did not represent a transfer of an interest of the debtor, then the transfer would represent a transfer of assets otherwise available to the debtor’s creditors, thus depleting the estate available for distribution. (According to Section 2-326, the goods were available to the consignee’s creditors.) The debtor/consignee would not receive reasonably equivalent value. Consequently, the transactions are sitting ducks for fraudulent transfer attack. Diamond, Inc. could be held liable for the value of all diamonds delivered and thereafter returned. That is not a pretty thought for Diamond, Inc. It would represent state and federal fictions “gone over board.”

This article did not discuss the possibility of considering the consignment transaction as an executory contract. It did not do so for several reasons. First, this article focuses on the consignor who fails to publicize its ownership interest. The consignee of such a consignor can avoid any entanglement with Section 365 because the consignee, as DIP, can “avoid” the consignor’s ownership interest in the consigned goods. Second, even assuming a publicized consignor, one wonders if an executory contract analysis could go anywhere. If the consignor has filed, one assumes it has established its ownership interest in the goods. The consignor can request relief from the stay and obtain a return of its goods. It does not seem likely that a court would allow a consignee to “reject” the consignment contract, that is, to keep the goods and leave the consignor with a pre-petition claim for damages. When a lessee “rejects” a lease, the lessor is entitled to a return of its goods (or premises) as well as a claim for damages caused by the lessee’s breach. What would happen if the consignee “assumed” the consignment contract? Presumably, the consignee would continue to have the right either to sell the goods on the consignor’s behalf or to return them. If the consignment contract requires the consignee to return any unsold goods after notice from the consignor, assumption would not appear to give the consignee any appreciable advantages.

Third, to my knowledge only one consignment case, In re Sun Bakery, Inc., 5 Bankr. 670 (Bankr. D. Mass. 1980), has involved an executory contract analysis. This case did not seem helpful or relevant for the following reasons. First, it was the consignor who sought to characterize the contract as executory so it could be rejected [the consignor was the debtor]. Second, the consignment contracts were exclusive franchise agreements (for which the exclusive franchisees had fully paid).
V. CONCLUSION

A court recently remarked, "[t]he Uniform Commercial Code's provisions regarding consignments are not models of draftsmanship." [Author's note: This court's observation gives new meaning to the word "understatement."] When courts are forced to apply a confusing state law scheme to determine federal bankruptcy rights, confusion inevitably occurs. Of course, life as well as the law regarding consignments would be far simpler if consignors filed or otherwise gave notice of their ownership interests. Perhaps many do. We never hear about them because their stories are not recorded in the case law.

The case law story is about consignors who did not give public notice. They are the unintending villains of this article, the rouges who have complicated the lives of judges and attorneys and caused brain strain to readers of the case law.

There is a way out from under the confusion. With respect to goods in the possession of the consignee at the date of the petition, courts should rely on the trustee's lien creditor status and rights under Section 544(a). At state law, a lien creditor could preclude the consignor from asserting its ownership claim. The trustee, as a lien creditor, can accomplish the same thing in bankruptcy. As a result, the goods will become property of the estate and will be available to creditors of the consignee/debtor. The consignor will be treated as a seller holding an unsecured claim for the value of the goods.

In terms of consigned goods returned during the ninety days preceding bankruptcy, if we view preference law as establishing what will or should become property of the estate and what federal bankruptcy must protect and preserve to distribute to the debtor's creditors, a return of consigned goods during the ninety days preceding bankruptcy should constitute a preference. The trustee's ability to recover the goods or their value should be subject to the policy constraints established in Section 547.

A refusal to apply a preference mode of analysis could lead to one of two things, both of which are far more troubling than the present stretching required to make a preference analysis work. The law could allow the

Because the case involved an exclusive franchise right to sell, it seemed less of a "consignment case" and more of a traditional "executory contract case." The court allowed the consignor to reject.


191 Mr. Weiner's article, which argues that diamond dealers cannot possibly comply with the notice requirements, deserves serious consideration. If the law requires that which is impossible, the law is not fairly treating the jewelry industry. See, Weiner, The Diamond Industry's Dilemma: UCC Consignment Provisions, 17 U.C.C.L.J. 99 (1984).
non-publicized consignor to recapture its goods as the consignee/debtor slides into bankruptcy. That approach would violate the spirit of both federal preference law and state law. Alternatively, the law could determine the consignor’s rights under fraudulent conveyance law.

The courts have reached results which are consistent both with state law and the federal bankruptcy policies underlying the strong-arm clause and the preference provision. It is the courts’ reasoning which causes “Excedrin” headaches. Perhaps this article has suggested an easier way.