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PROPOSED SECTION 9-114 OF THE UNIFORM COMMERCIAL CODE: THE CONSIGNOR'S PRIORITY IN HIS GOODS

*by Ronald A. Anderson**

INTRODUCTION

Creditors are constantly concerned about the rights each possesses in a debtor's property when the debtor defaults in the payment of the debt. A creditor's interest extends not only to identifying the specific property of the debtor which he may reach, but also to recognizing his position vis-à-vis other creditors of the same debtor in obtaining the property. Article Nine of the Uniform Commercial Code (the Code) has given most creditors definitive answers to questions regarding the nature of his interest, his priority over other creditors, and necessary procedures for maintaining that priority.

However, the Code has accorded one type of creditor—the consignment seller—treatment different from that generally accorded other creditors.¹ While giving up possession of the goods to allow another

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1. Section 2-326 provides:

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is

- (a) a "sale on approval" if the goods are delivered primarily for use, and
- (b) a "sale or return" if the goods are delivered primarily for resale.

(2) Except as provided in subdivision (3), goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

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

- (a) complies with an applicable law providing for a consignor's interest or the

to sell the product, this creditor retains title to the goods in himself. This device of selling goods on consignment is not dealt with in Article Nine of the 1962 version of the Code, but rather is treated under the article dealing with sales—Article Two. Section 2-326 of Article Two provides that the goods delivered to the consignee are deemed to be fully owned by the consignee, insofar as the consignee's creditors are concerned, irrespective of the consignor's retention of title, unless the consignor

- (a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or
- (b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or
- (c) complies with the filing provisions of the Article on Secured Transactions (Article 9).²

By providing for the rights of the consignor in an article other than the one dealing with security interests in general, the Code created the impression that a consignor was different from other creditors. If a consignor chose to protect his title to the goods by filing under Article Nine, it was unclear whether filing alone was sufficient, or whether, in addition, a consignor had to give notice to other prior filing creditors³ of the debtor.⁴ Such notice is generally required by Article Nine when

like to be evidenced by a sign, or

- (b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or
- (c) complies with the filing provisions of the Article on Secured Transactions (Article 9).
- (4) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this Article (Section 2-201) and as contradicting the sale aspect of the contract within the provisions of this Article on parol or extrinsic evidence (Section 2-202).

UNIFORM COMMERCIAL CODE § 2-326 [hereinafter cited as UCC].

2. UCC § 2-326(3).

3. The phrase "prior filing creditor" is used by the text for the sake of simplicity, because ordinarily the party over whom the consignor seeks to prevail is a secured creditor of the consignee who has already filed and whose security interest extends to after-acquired inventory. It is noted that the exact language of the Code amendment is "a secured party who is or becomes a creditor of the consignee and who would have a perfected security interest in the goods if they were the property of the consignee" UCC § 9-114(1). Should a case arise in which the creditor of the consignee is not a prior filing creditor but does come within the above-quoted language of section 9-114, the phrase "prior filing creditor" as used in the text is to be read as embracing such other creditor. In using the phrase "first filing creditor," there was no intent to indicate that the quoted language is necessarily restricted to a prior filing creditor.

4. UCC § 9-114, Comment 1.

a creditor seeks to gain a prior position over those creditors who would have had a prior security interest in the goods the debtor is selling.⁵

I. THE 1972 CODE AMENDMENT

To remove the confusion thus created, the drafters of the Uniform Commercial Code adopted a 1972 provision under Article Nine which specifically deals with the consignor, his rights, and the necessary procedures to preserve his rights. This new Code provision, section 9-114, provides:

- (1) A person who delivers goods under a consignment which is not a security interest and who would be required to file under this Article by paragraph (3)(c) of Section 2-326 has priority over a secured party who is or becomes a creditor of the consignee and who would have a perfected security interest in the goods if they were the property of the consignee, and also has priority with respect to identifiable cash proceeds received on or before delivery of the goods to a buyer, if
 - (a) the consignor complies with the filing provisions of the Article on Sales with respect to consignments (paragraph (3)(c) of Section 2-326) before the consignee receives possession of the goods; and
 - (b) the consignor gives notification in writing to the holder of the security interest if the holder has filed a financing statement covering the same types of goods before the date of the filing made by the consignor; and
 - (c) the holder of the security interest receives the notification within five years before the consignee receives possession of the goods; and
 - (d) the notification states that the consignor expects to deliver goods on consignment to the consignee, describing the goods by item or type.
- (2) In 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.

The potential problems and ambiguities of this section and the requirements a consignor must now follow to preserve a superior interest in his goods will be explored in this Article.

II. APPLICABILITY OF UCC § 9-114

In a quest for a precise understanding of section 9-114 and its opera-

5. Uniform Commercial Code section 9-312(3) requires a purchase money financier of inventory to notify other creditors who have filed as to the debtor's inventory if such creditor desires to obtain priority over the interests of the previously filing creditors.

tion, the first question to be analyzed is to whom does it apply. Does it apply to all consignors or only to those who could not or chose not to protect their interest by reliance on the sign law or upon the general reputation of the consignee as such as provided for in section 2-326 (3) (a) and (b) of the Code?

Unfortunately, section 9-114 does not expressly answer the question. The section itself states that it is applicable to those "who would be required to file under . . . Article [Nine] by paragraph 3(c) of Section 2-326 . . ." Section 2-326(3)(c) is not a mandatory provision requiring filing by a consignor; rather, it merely provides an additional option to a consignor to preserve an interest in his goods. Assuming, however, that the drafters of the new provision did not intend it to be a nullity, the question remains whether the intended class to be covered was all consignors or only those who sought to fall under subsection (3)(c) of section 2-326.

Initially, it could be argued that the drafters' intent was to resolve all uncertainty by requiring all consignors to follow the prescriptions of section 9-114 if they seek to protect their interest in the goods. Indeed, the comments of the Editorial Board lend support to this interpretation:

The new Section 9-114 . . . provides in substance that, in order to protect his ownership of the consigned goods, the consignor must give the same notice to an inventory secured party of the debtor that he would have to give if his transaction with the consignee was in the form of a security transaction⁶

The Comment does not say that the consignor *who files* under Article Nine must give notice; it places no limiting description on its use of consignor.

Further, a policy argument could be made in favor of applying section 9-114 to all consignors. If section 9-114 does not apply to all consignors, a disparity of treatment of the prior secured creditors would result. When a consignor chooses to post a sign at the consignee's place of business or to rely upon the general reputation of a consignee as such, the prior secured party stands much less chance of receiving actual notice that the inventory does not in fact belong to the consignee free and clear. Whereas under section 9-114, such creditor's interest is much more carefully and explicitly provided for: he must receive actual notice⁷ of the consignor's interest or his priority over the

6. UCC § 9-114, Official Reasons for Adoption.

7. UCC § 9-114(1)(c).

consignor is retained.⁸ Such disparity should be discouraged as a matter of policy, if not prohibited as a matter of constitutional law.

An additional policy argument can be made in terms of judicial economy. If all consignors were required to follow the same specific procedures outlined in section 9-114, or be relegated to the position of a general unsecured creditor, courts would not have to resolve issues of a consignee's "general reputation." The status under section 9-114 is more easily and objectively ascertained than that under section 2-326(3)(b).

While the above suggests a conclusion that section 9-114 has a broad application to all consignors, the arguments supporting a more limited reading of the statute compel a conclusion that the section will apply only to consignors who choose to preserve a prior interest by filing under Article Nine.

The first argument, and perhaps the most persuasive, is that to read section 9-114 in the more expansive sense is to effectively repeal section 2-326(3)(a) and (b). The Editorial Board has stated that the reason for the adoption of section 9-114 is to clear up uncertainties surrounding section 2-326(3)(c);⁹ it does not claim to address itself to section 2-326(3)(a) or (b). Furthermore, section 1-104 of the Code provides that "no part of [the Code] shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided."¹⁰ While section 1-104 of the Code may have contemplated only a subsequent non-Code statute, it is not so limited, and its underlying policy and rationale should be applicable as well to the situation in which the later legislation is, as in the case of section 9-114, an amendment to the Code.

Secondly, section 9-114 was enacted to insure that an inventory secured creditor would receive *notice* of the consignor's interest before a consignor could have priority over an earlier perfected security interest in the consigned goods.¹¹ Section 2-326(3)(a) and (b) had already provided for a type of notice; hence, the policy of the Code that one with a prior perfected security interest will have priority unless otherwise notified was satisfied.

It must therefore be concluded that section 9-114 is applicable to

8. UCC § 9-114(2).

9. UCC § 9-114, Comment 1.

10. UCC § 1-104.

11. UCC § 9-114, Comment 1.

any consignor who seeks to protect his interest pursuant to section 2-326(3)(c) by complying with the provisions of Article Nine of the Code. It has no application to the consignor who relies upon the procedure provided for in section 2-326(3)(a) or (b).

III. CONSIGNOR'S FILING AND NOTICE

With the resolution of the scope of section 9-114, the question arises as to what the section requires of the consignors to whom it is applicable. The section explicitly provides that a consignor must comply "with the filing provision . . . before the consignee receives possession of the goods"¹² and that he must give notice "in writing to the holder of the security interest if the holder has filed a financing statement covering the same types of goods before the date of the filing made by the consignor" While the requirements that a consignor file a financing statement and give notice to all those creditors who otherwise would have had an earlier perfected security interest in the consignor's goods may appear to be obvious and simple, several problems must be examined.

A. Duration of Filing

Once a consignor has filed a financing statement covering the type of goods he is to ship to the consignee as section 9-114 provides, is that filing good for all time? Ordinarily, a creditor who files a financing statement pursuant to Article Nine must refile every five years to retain his interest.¹³ If a creditor fails to file a continuation statement, his security interest becomes unperfected.¹⁴ By the wording of section 9-114, the application of this requirement to a consignor's filing is uncertain. The structure of section 9-114 suggests that no durational limit is imposed on the consignor's financing statement. In section 9-114(1)(a) the only time limitation explicitly expressed with respect to filing is that it be filed prior to receipt of the goods by the consignee. This inclusion of an additional imposition of a time requirement not otherwise required of Article Nine creditors gives rise to the implica-

12. Since possession has not been defined by the Code, section 1-103 requires one to look to pre-Code law to discover its meaning. At common law possession has generally been defined as subjecting the item to one's dominion and control. See *In re Automated Book Binding Services*, 471 F.2d 546 (4th Cir. 1972); *National Cash Register Co. v. Firestone Co.*, 191 N.E.2d 471 (Mass. 1963).

13. UCC § 9-403(2).

14. UCC § 9-403(2).

tion that the Code requires no more of a consignor than that which section 9-114 explicitly prescribes.

Furthermore, by the express time limitation imposed upon the receipt of notice in subsection (1)(c) of section 9-114, the conclusion is supported that there is no durational implication in section 9-114(1)(a)'s filing requirement. The absence of any reference to a time of continued effectiveness supports the argument that the filing by the consignor once made is forever effective provided notice is given every five years to the prior secured creditors.

A contrary interpretation could be adopted if one were guided by section 2-326(3)(c). That section provides that the consignor must comply with "the filing provisions of . . . [Article Nine]." A requirement to comply with the "filing provisions" connotes more than a simple act of filing; it necessarily includes the additional Article Nine prescription to renew the financing statement every five years.

While some forceful arguments can be articulated in support of the contention that no time limit is imposed upon the effectiveness of a financing statement filed pursuant to section 9-114, it is strongly suggested that a consignor avoid any uncertainty by refile. With the renewal of the filing, a consignor not only would protect himself against claims of priority of those creditors to whom he has given notice, but also would avoid misleading subsequent creditors of the consignee.

Should a consignor not file a continuation statement after five years has expired, subsequent creditors might be injured. There is nothing in the financing statement which indicates that the status of the creditor is that of a consignor. Thus, when a potential creditor of the consignee searches the records six years after the consignor's filing of the financing statement he would be led to believe that the perfection of the security interest has lapsed. This in turn would lead the potential creditor to overestimate the collateral which the prospective debtor, the consignee, has available to secure a loan. It would appear preferable to protect subsequent creditors from such mistakes either by requiring a filing to indicate the status of the consignor as such or by expressly requiring consignors, like all Article Nine creditors, to file a continuation statement.

B. What Constitutes Notice

The next issue to be resolved is what must a consignor do to satisfy the notice requirements of section 9-114. Notice must be given to any

prior creditor of the consignee who has filed a financing statement¹⁵ covering the type of goods in which the consignor seeks to preserve his prior interest.¹⁶ By implication, notice need not be given to any creditor who has not filed a financing statement, including a creditor who has obtained a lien against the consignee. The consignor has no duty to deliver actual notice of his interest to creditors who may file after the consignor has filed since the prior filed financing statement serves as notice to subsequent creditors.

Subsection (b) of section 9-114 requires a consignor to "give" notice, but subsection (c) makes it clear that a mere giving is not sufficient. The prior filing creditor must "receive" the consignor's notice,¹⁷ and he must receive it within five years preceding the time when the consignee has received possession of the consigned goods. This in effect requires the sending of renewal notices every five years so that, regardless of when the consignee receives particular goods, the prior filing creditor will have received notice within the preceding five years.

C. *Content of Notice*

The content of the notice is prescribed by section 9-114(d). The consignor must state that he expects to deliver goods on consignment and describe "the goods by item or type." The consignor should take care that the description of the goods is sufficient to give the creditors adequate notice of which goods are to be covered. In this regard section 9-110 of the Code¹⁸ provides in part:

For the purposes of [Article Nine] any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.¹⁹

15. UCC § 9-114(1)(b).

16. UCC § 9-114(1)(d).

17. Definition of the word "receive" is provided in section 1-201(26). It states, in part:

A person "receives" a notice or notification when

(a) it comes to his attention; or

(b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

UCC § 1-201 (26).

18. UCC § 9-110.

19. UCC § 9-110. "The test of sufficiency of a description laid down by this Section is that the description do the job assigned to it—that it make possible the identification of the thing described." UCC § 9-110, Comment. Notwithstanding section 9-110, there may be a judicial risk in an overly broad or too specific description of the con-

Commercial practicality, as well as section 9-110, should dictate the conclusion that a general description of the category of the product would be sufficient. A consignor contemplating a continuing relationship with a certain consignee should describe the consignor's entire output in general terms. When a consignor expands his product line, he should immediately give notice to all prior secured creditors of all his consignees, rather than waiting to notify until he expands his line with the various individual consignees. This procedure would avoid the possibility of failing to re-notify creditors of various consignees as the consignor later begins to ship the new goods. Once the goods have been received by the consignee, notice to the prior creditors is insufficient to preserve a prior position over them.

While the consignor should seek to describe his entire array of products, care must be taken to avoid a description which is so broad that it would include items not supplied by the consignor. Thus, the consignor of washing machines should not describe the goods as "household appliances" for the reason that there are items which are "household appliances" which are not washing machines. In contrast, a description of "washing machines" should be sufficient to cover any kind, make, or model of washing machine and would therefore be a sufficient description of washing machines.

In addition to the express requirements of section 9-114(d), the notice should contain the names and addresses of the consignor and consignee. While this is not expressly required by the Code, it would appear implicit in the requirement of notice. If the notified creditor is not informed of the names and addresses of the consignor and consignee, he would not be informed as to the person claiming to be the consignor, the person involved as consignee, or the addresses which he should use to locate the parties in seeking additional information.

A consignor may also wish to include a statement that he has filed a financing statement in the appropriate place. While this is not required, the consignor may, as a practical matter, avoid any future questions as to whether he did all he must do to fully protect his interest.

signed goods. See *In re Laminated Vaneers Co.*, 471 F.2d 1124 (2d Cir. 1973); *Piggott State Bank v. Pollard Gin Co.*, 419 S.W.2d 120 (Ark. 1967); but see *United States v. First National Bank*, 470 F.2d 944 (8th Cir. 1973); *National Cash Register v. Firestone Co.*, 191 N.E.2d 471 (Mass. 1963).

IV. EFFECT OF NONCOMPLIANCE

If a consignor complies with the filing and notice provisions of section 9-114, he has an interest in the consigned goods which is superior to that of the consignee and any third party.²⁰ Further, the consignor's interest has priority over the security interest of *any* other creditor of the consignee.²¹ The act of filing protects the consignor's interest as against any subsequent creditor of the consignee and the additional act of notifying prior filing creditors protects his interest as against prior filing creditors. Compliance with section 9-114 affords an additional protection for the consignor. Once the consigned goods have been sold, he also has an interest in the "identifiable cash proceeds received on or before delivery of the goods to [the] buyer"²² which has priority over the claims of any other creditor of the consignee.

The effect of noncompliance is governed by section 9-114(2) and section 2-326(3). If the consignor has not complied with subsection (a), (b), or (c) of section 2-326 or with section 9-114, the consignor is in the position of a general unsecured creditor. But what if the consignor's noncompliance is not total, if he has given notice or has filed, but not both?

When the consignor files properly and the only element of noncompliance is the non-receipt of notice by a prior filing creditor, the interest of the consignor is subordinated only to the interests of the prior filing creditors.²³ Any prior filing creditor who does not receive notice is not subordinated to the consignor. Thus, the fact that prior filing Creditor *A* received notice of the consignor's interest does not have any significance with respect to prior filing Creditor *B*. If the consignor notifies *A* only, the consignor has priority over *A* only, and *B* will not be subordinated to the interest of the consignor. Since there was a filing, the consignor would prevail over all other subsequent filing creditors by virtue of the filing. The absence of notice only bars the consignor with respect to the particular prior filing creditor who was not notified.²⁴

20. UCC § 9-114(1).

21. UCC § 9-114(1).

22. UCC § 9-114(1).

23. UCC § 9-114(2).

24. UCC § 9-114(2). It should be noted that if the consignor is granted a prior position over Creditor *A* to whom he has given notice and not Creditor *B* who has received no notice, circular priorities could result. If *A* has priority over *B* in the consignee's inventory, then the consignor would be prior to *A* and junior to *B*; but *B* is junior to *A*. The Code does not provide a method for dealing with circular priorities. One

In the event that the consignor gives notice to the prior filing creditors, but fails to file or comply with the alternatives provided in section 2-326(3)(a) or (b), it appears that he would have no priority over any creditor and would be relegated to the position of a general, unsecured creditor.²⁵ However, it is quite likely that a court would be receptive to arguments to avoid such a literal application of the statute. One could argue that, since the creditor received actual notice, he acquired all the information necessary to protect his interest. Moreover, he would not have any greater information by the fact of filing on the part of the consignor. Additionally, the purpose of section 2-326(3) is to provide all creditors whose interest is to be subordinated to the consignor with notice of that fact. Since the giving of actual notice to creditors, albeit without a filing, complies with the purpose of section 2-326(3), the consignor should prevail over all creditors to whom he gave actual notice.

A court might conclude that equitable principles, not displaced by the Code,²⁶ and the duty to interpret the Code liberally,²⁷ when coupled with the overriding obligation to act in good faith,²⁸ and the constant emphasis made by the Code upon commercial reasonableness, permit the consignor to prevail over the creditor who received notice, even though the consignor had not filed. With respect to all other creditors of the consignee, the fact that notice was given to one creditor is immaterial. Unless the consignor has satisfied a sign statute or the general reputation test, he has no position of priority in the consigned goods or in their proceeds.

CONCLUSION

It is recommended that a consignor avail himself of the advantage of having an interest in his goods which has priority over all other creditors of a consignee by completing the relatively simple act of filing a financing statement and giving the prior filing creditors of the consignee notice of such filing. Any ambiguities or uncertainties surrounding reliance upon the consignee's reputation as such or compli-

method which has been suggested would allow *A* to satisfy his claim in the goods, subject to the claim of the consignor. The consignor may satisfy his claim in the goods only to the extent of *A*'s claim. *B* may then satisfy his claim to the extent that any proceeds remain after *A* has satisfied his claim. See 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 1020-46 (1965).

25. UCC § 2-326(3).

26. UCC § 1-103.

27. UCC § 1-102(1).

28. UCC § 1-203.

ance with a sign statute can be circumvented. The consignor's position is thus made certain vis-à-vis other creditors of the consignee and the danger that other creditors might be misled is avoided.²⁹

29. California has adopted section 9-114, to become effective on January 1, 1976. Ch. 997, § 15, [1974] Cal. Stat. Arkansas, Illinois, Iowa, Nevada, North Dakota, Oregon, Texas, West Virginia, and Wisconsin have also adopted the section. UCC REPORTING SERVICE [CURRENT MATERIALS] app. at 2 (1974).