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## CASE COMMENTS

CONSIGNMENT SALES UNDER SECTION 2-326  
OF THE UCC

Section 2-326<sup>1</sup> of the Uniform Commercial Code has filled an apparent loophole in the common law of consignment sales. The section fills a gap left by the Uniform Sales Act<sup>2</sup> and by the pre-existing case law and statutes in most jurisdictions.<sup>3</sup> The common law consignment sale is based on a combination of the concepts of bailment and agency under which a manufacturer places his goods in the possession of his agent for the purpose of selling them to a third party. Since ownership never vests in the consignee, the consignor is able to retain, without recordation, a security interest in the goods, and receives other significant advantages from the delay in the transfer of

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<sup>1</sup>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 subsection (3), goods held on approval are not subject to the claims of the buyer’s creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer’s possession.

(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 subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as ‘on consignment’ or ‘on memorandum.’ However, this subsection is not applicable if the person making delivery (a) complies with an applicable law providing for a consignor’s interest or the like to be evidenced by a sign, or (b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or (c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

(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).”

<sup>2</sup>Both the “sale on approval” and the “sale or return” were treated under Uniform Sales Act § 19(3).

<sup>3</sup>But see Miss. Code Ann. § 273 (1957); Va. Code Ann. § 55-152 (repl. vol. 1959). West Virginia had a similar statute, W. Va. Code Ann. § 4654 (1961), which was repealed when the Uniform Commercial Code became effective on July 1, 1964. See, W. Va. Code Ann. § 4654 (Supp. 1964). See also, Note, 27 Va. L. Rev. 962 (1941).

ownership. At the same time, the consignor may fail to create a true consignment relationship, with the result that the transaction will be treated as an absolute sale to the agent, thereby subjecting the goods to the claims of the agent's creditors.

A recent decision of the Supreme Court of Massachusetts, *General Electric Co. v. Pettingell Supply Co.*,<sup>4</sup> held that the consignor of lamps had no right to replevy the lamps from an assignee for the benefit of creditors of the consignee. General Electric had consigned lamps to the Pettingell Supply Company. Pettingell made an assignment of its assets to Miller, an assignee for the benefit of creditors. General Electric Company, in turn, replevied the lamps from Miller. The sole issue presented to the court was whether, under section 2-326 of the Uniform Commercial Code, which Massachusetts has enacted,<sup>5</sup> the goods consigned by the plaintiff, General Electric Company, could be subjected to the claims of the creditors of Pettingell Supply Company.

The court held that the plaintiff corporation had no right to replevy the goods from the defendant's assignee because subsection 2-326(3) of the UCC specifically provides that a consignment sale is to be deemed a sale or return,<sup>6</sup> and subsection 2-326(2) states that such goods are subject to the claims of creditors of the buyer.<sup>7</sup> General Electric conceded that it was unable to bring itself within the exceptions provided in subsection 2-326(3) of the statute:<sup>8</sup> (1) establishing that the defendant was known by its creditors to be substantially engaged in selling goods belonging to others,<sup>9</sup> or (2) conforming to the filing provisions of article 9 of the UCC.<sup>10</sup> General Electric also con-

<sup>4</sup>199 N.E. 2d 326 (Mass. 1964).

<sup>5</sup>The Uniform Commercial Code is contained in chapter 106 of the Massachusetts General Laws Annotated. The Uniform Commercial Code became effective in Massachusetts on October 1, 1958.

<sup>6</sup>The "sale or return" was treated by the Uniform Sales Act under § 19(3)(1). "When goods are delivered to the buyer 'on sale or return,' or on other terms indicating an intention to make a present sale, but to give the buyer an option to return the goods instead of paying the price, the property passes to the buyer on delivery, but he may revest the property in the seller by returning or tendering the goods within the time fixed in the contract, or if no time has been fixed, within a reasonable time."

<sup>7</sup>"(2) Except as provided in Subsection (3), goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyers possession."

<sup>8</sup>199 N.E.2d at 328. Massachusetts does not have a statute similar to Virginia's "Traders Act," therefore § 2-326(3)(a) was not a possible alternative for the plaintiff.

<sup>9</sup>UCC § 2-326(3)(b).

<sup>10</sup>UCC § 2-326(3)(c). See UCC § 1-201(37) which defines a security interest. See also UCC § 9-102(2): "This article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's

ceded that the assignment for the benefit of creditors was valid if the defendant's creditors were found to have claims under the section.<sup>11</sup>

### *Consignment Sales Prior to the UCC*

In concept, a consignment is a bailment to an agent with authority to sell upon terms dictated by the wholesaler or manufacturer.<sup>12</sup> Title to the goods is at no time in the consignee, but rather passes directly from the consignor to the ultimate purchaser of the goods.<sup>13</sup> Under the terms of most consignment contracts the consignor is given unlimited power to take back goods in the possession of the consignee.<sup>14</sup> In return for the consignee's services as a sales agent, the consignee retains a fixed percentage of the proceeds from each sale. The sale price, less commission, is remitted to the consignor only after the goods have been sold by the agent, since remittance at an earlier time will generally convert the entire transaction into an absolute sale to the agent.<sup>15</sup> Because the consignor has reserved title to the goods, he may retain through the use of express terms in the consignment contract the privilege of himself making sales from the consignee's stock.<sup>16</sup>

The advantages running to the parties to the consignment contract are numerous.<sup>17</sup> An untried line of merchandise may be marketed without requiring the retailer to expend limited funds. In addition, the consignor avoids the necessity of public recordation and the

lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security." See generally Spivak, *Secured Transactions (Under the Uniform Commercial Code)* (1963).

<sup>11</sup>199 N.E.2d at 328. Since General Electric had not availed itself of any of the exceptions under § 2-326(3), the assignment for the benefit of creditors was valid because the goods are treated, with respect to creditors, as a sale or return, placing all incidents of ownership in Miller, the assignee.

<sup>12</sup>E.g., *Sargent & Co v. DeSoto Paint & Varnish Co.*, 768 Tenn. 247, 77 S.W.2d 444 (1935); *General Electric Co. v. Martin*, 99 W. Va. 519, 130 S.E. 299 (1925). See 4 *Collier, Bankruptcy* § 70.59 (14th ed. 1964); 2 *Williston Sales* § 338 (rev. ed. 1948).

<sup>13</sup>*Rio Grande Oil Co. v. Miller Rubber Co.*, 31 Ariz. 84, 250 Pac. 564 (1926); *In re Taxes*, 46 Hawaii 403, 380 P.2d 156 (1963); *National Furniture Mfg. Co. v. Price*, 195 N.C. 602, 143 S.E. 208 (1928).

<sup>14</sup>*Kemp-Booth Co. v. Calvin*, 84 F.2d 377 (9th Cir. 1936); *Reliance Shoe Co. v. Manly*, 25 F.2d 381 (4th Cir. 1928); *In re Lexington Appliance Co.*, 202 F. Supp. 869 (D. Md. 1962); *R. Carrillo & Co. v. McAlfee Bros. Furniture Co.*, 42 Ohio App. 259, 182 N.E. 43 (1932).

<sup>15</sup>E.g., *Tele-King Distrib. Co. v. Wyle*, 218 F.2d 940 (9th Cir. 1955); *Globe Sec. Co. v. Gardner Motor Co.*, 337 Mo. 117, 85 S.W.2d 561 (1935).

<sup>16</sup>E.g., *In the Matter of Wright-Dana Hardware Co.*, 211 Fed. 908 (2d Cir. 1914); *In the Matter of Prager*, 173 F. Supp. 859 (D.N.H. 1958).

<sup>17</sup>See, *Vold, Sales* § 64, at 330 (2d ed. 1959).

possibility of having his goods subjected to the claims of the agent's creditors.<sup>18</sup> Recording is unnecessary because the consignor has not released any property in which he must retain a security interest, since he constructively retains possession through an agent. Finally, the consignor, by virtue of the fact that he remains the owner of the goods until they are sold to the ultimate consumer, has an opportunity to determine the retail price without contravening the federal anti-trust laws.<sup>19</sup> Resale price maintenance, when utilized through consignment sales, was approved in *United States v. General Electric Co.*<sup>20</sup> However, this case has recently been limited by the Supreme Court of the United States.<sup>21</sup>

Because the consignment sale, absent a statute to the contrary, does not require public recordation, creditors may be misled and so find cause to challenge the transaction.<sup>22</sup> Ostensibly the goods stocked in the consignee's place of business are owned by the consignee; therefore unwary creditors may be surprised to learn that as to a large portion of this merchandise, ownership lies elsewhere.

Cases testing the validity of particular consignments have generally arisen in one of the following situations: (1) creditors of the consignee levy upon consigned goods;<sup>23</sup> (2) the consignee is adjudged a

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<sup>18</sup>*Fowler v. Pennsylvania Tire Co.*, 326 F.2d 526 (5th Cir. 1964); *United States v. Menier Hardware No. 1, Inc.*, 219 F. Supp. 448 (W.D. Tex. 1963); *In the Matter of Prager*, 173 F. Supp. 839 (D.N.H. 1958).

<sup>19</sup>Some decisions have held intended consignment sales to be invalid partially because the consignee determined the price at which the goods were to be sold to the consumer. See e.g., *In re Wayside Furniture Co.*, 67 F.2d 201 (7th Cir. 1933); *Reliance Shoe Co. v. Manly*, 25 F.2d 381 (4th Cir. 1928).

<sup>20</sup>272 U.S. 476 (1926). See also Klaus, *Sales Agency and Price Maintenance*, 28 *Colum. L. Rev.* 312 (1928).

<sup>21</sup>*Simpson v. Union Oil Co.*, 377 U.S. 13 (1964). This case involved a private anti-trust case seeking damages. The Supreme Court reversed the Circuit Court of Appeals and in a 5-3 decision held that "coercive" consignments were in violation of the Sherman Act. Douglas, J., writing the majority opinion stated: "To allow Union Oil to achieve price fixing in this vast distribution system through this 'consignment' device would be to make legality for antitrust purposes turn on clever draftsmanship. We refuse to let a matter so vital to a competitive system rest on such easy manipulation." 377 U.S. 13, 24 (1964). Stewart, J., dissenting, was of the opinion that the majority had impliedly overruled *United States v. General Electric*. 377 U.S. 13, 29 (1964).

<sup>22</sup>*Liebowitz v. Voiello*, 107 F.2d 914 (2d Cir. 1939). See also Hawkland, *Consignments Under the Uniform Commercial Code: Sale or Security?*, *Boston College Industrial and Commercial L. Rev.*, Uniform Commercial Code Co-ordinator 395 (1963); Hawkland, *Consignment Selling Under the Uniform Commercial Code*, 67 *Com. L.J.* 146 (1962).

<sup>23</sup>*City of San Antonio v. Stieff, Inc.*, 83 S.W.2d 357 (Tex. Civ. App. 1935); *General Electric Co. v. Martin*, 99 W. Va. 519, 130 S.E. 299 (1925).

bankrupt;<sup>24</sup> (3) a corporation which has acted as a consignee is taken over by a receiver because of insolvency;<sup>25</sup> or (4) an attempt is made to collect property or sales taxes from the consignee.<sup>26</sup> Courts which are called upon to examine the validity of a consignment arrangement use no single criterion for reaching a decision, but rather scrutinize the underlying intentions of the parties to assure that the agency was not created merely to defraud creditors.<sup>27</sup>

### *Consignment Sales Under the UCC*

Section 2-326 of the UCC, like the other sections of the Code, has abandoned the concept of title as a determining factor in deciding the rights of parties to a contract, and has substituted a statement of the legal consequences resulting from particular relationships.<sup>28</sup> This policy is demonstrated in the approach taken to consignment sales in that terminology such as "on consignment" or "on memorandum" is deemed to have no special legal significance which will immunize property from the claims of a consignee's creditor. The Comment states that "subsection (3) resolves all reasonable doubts . . . in favor of the general creditors of the buyer."

The effect of subsection 2-326(3) upon consignment sales is clearly illustrated by the result reached in *General Electric Co. v. Pettingell Supply Co.*, a case of first impression arising under this section of the

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<sup>24</sup>Ludvigh v. American Woolen Co., 231 U.S. 522 (1913); Fowler v. Pennsylvania Tire Co., 326 F.2d 526 (5th Cir. 1964); General Electric Co. v. Brower, 221 Fed. 597 (9th Cir. 1915); In re Sachs, 21 F.2d 984 (D. Md. 1927); Harry Winston, Inc. v. Levin, 130 So. 2d 717 (La. App. 1961).

<sup>25</sup>E.g., National Furniture Mfg Co. v. Price, 195 N.C. 602, 143 S.E. 208 (1928).

<sup>26</sup>E.g., In re Taxes, 46 Hawaii 403, 380 P.2d 156 (1963); Department of Treasury v. Ice Serv., Inc., 220 Ind. 64, 41 N.E.2d 201 (1942); City of Owensboro v. Dark Tobacco Grower's Ass'n, 222 Ky. 164, 300 S.W. 350 (1927).

<sup>27</sup>Liebowitz v. Voiello, 107 F.2d 914 (2d Cir. 1939); Reliance Shoe Co. v. Manly, 25 F.2d 381 (4th Cir. 1928); Long Tobacco Harvesting Co. v. Brannen, 98 Ga. App. 142, 105 S.E.2d 390 (1958); Frick Co. v. Walter Cox Co., 101 Ind. App. 402, 199 N.E. 462 (1936); Tenela Oil Co. v. Blount, 368 S.W.2d 655 (Tex. Civ. App. 1963); Best Made Clothing Co. v. O'Brien, 145 Misc. 787, 262 N.Y.S. 56 (City Ct., Kings County 1932). See also, Note 26 Va. L. Rev. 819 (1940).

<sup>28</sup>The Comment to § 2-101 states in part: "The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character." See generally Hawkland, Sales and Bulk Sales (Under the Uniform Commercial Code) (1958).

UCC.<sup>29</sup> The case is significant because it reverses the outcome which would have been reached under the law prior to the adoption of the UCC, where under the same facts General Electric could have replevied the lamps consigned to Pettingell Supply Company.

Consignors of merchandise, however, can continue to enjoy their former status by bringing themselves within one of the three exceptions to subsection 2-326(3). In states with Traders Acts, such as Virginia, consignors may continue to comply with these statutes, if they were not repealed by the adoption of the UCC.<sup>30</sup> In other jurisdictions consignors will be required to comply either with the filing provisions of article 9 of the UCC,<sup>31</sup> or prove that the creditors of the consignee had knowledge that the consignee was substantially engaged in selling goods of others.<sup>32</sup>

Subsection 2-326(3) of the Uniform Commercial Code, by requiring the giving of constructive notice to creditors of the existence of a consignment of merchandise, has removed the primary grounds for a creditor's criticism of the consignment sale. At the same time, the consignment sale has not been stripped of its usefulness as a business device. The UCC has not affected the consignor's ability to set retail prices, unless the consignor drafts his contract so ambiguously that under subsection 2-326(1) the transaction is deemed to be a sale on approval or a sale or return.<sup>33</sup>

The option given the consignor, of establishing that creditors of the consignee are on notice of the existence of a consignment between a principal and agent, appears to be a tenuous alternative in light of the evidentiary problems that would necessarily be involved. For this reason, the third alternative of filing in accordance with article 9 of the UCC seems the only satisfactory choice for most consignors in the majority of states in which the Uniform Commercial Code is effective.

STANLEY P. ATWOOD

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<sup>29</sup>This case is evidently the first case brought under § 2-326 of the UCC to reach the highest court of any state. The section has been alluded to, however, in *United States v. Menier Hardware No. 1, Inc.*, 219 F. Supp. 448, 467 (W.D. Tex. 1963). *Rock-Ola Mfg. Corp. v. Music & Television Corp.*, 339 Mass. 416, 159 N.E.2d 417 (1959).

<sup>30</sup>See note 3 *supra*.

<sup>31</sup>See note 10 *supra*.

<sup>32</sup>Even though a consignor complies with one of the exceptions to § 2-326, it may be discovered that the transaction was in fact an outright sale and therefore that the consignor had no security interest which could attach.

<sup>33</sup>Hawkland, *Consignment Selling Under the Uniform Commercial Code*, 67 *Com. L.J.* 146, 148 (1962).