CONSIGNMENTS VS. SECURED TRANSACTIONS

A creditor delivering goods on a consignment basis must be careful to follow the dictates of KRS 355.2-326. Goods that are delivered primarily for resale, but can be returned by the buyer, even though they conform to the contract are considered "sale or return goods," and are subject to the claims of the buyer's creditors while they are in the buyer's possession. A consigning creditor can protect itself, however, by complying with the filing provisions of Article 9 (Secured Transactions) of the Uniform Commercial Code even though the consignment is not a security interest.

If a consigning creditor has complied with the Article 9 filing provisions, then it will be given priority over a secured party who is or becomes a creditor of the buyer and who would otherwise have a perfected security interest in the goods as part of the inventory of the buyer -- if the consignor first gives notice in writing to the holder of the security interest before delivering the goods to the buyer. Any secured party who has filed a financing statement covering the same type of goods before the date of filing made by the consignor, and who receives notification within the five years before the buyer receives possession of the goods -- so long as the notification states that the consignor expects to deliver goods on consignment to the buyer and describes the type of goods -- will have its interest in the consigned inventory subordinated by law to the rights of the consignor.

If a consigning creditor fails to comply with the filing provisions on secured transactions, KRS 355.2-326 leaves the consignor with two other chances. First, if its buyer complies with applicable laws providing for a consignor's interest to be evidenced by a sign displayed on the premises, then the consignor's goods will not be subject to the buyer's other creditors. Kentucky, however, has no such sign law.

The second chance hinges on whether the consignor can establish that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others. This issue is generally examined on a case by case basis. The exact evidence needed to establish that it was "generally known" by the debtor's creditors that the debtor was engaged in the selling of others goods is determined by the number of creditors and not by the proportionate share of claims against the debtor. The fact that some of the creditors possess knowledge of this practice is not enough to meet the burden of proof. Likewise, it is not necessary to prove that all the creditors possess knowledge. Even when the buyer is engaged in a line of business that is universally known to handle goods on a consignment basis, this is not enough to show that it was "generally known" by creditors that the particular debtor was engaged in such a course of business.

KRS 355.2-326 also provides that when goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, but under a name other than the name of the creditor making the delivery, then the goods will be deemed to have been delivered on a "sale or return" basis which subjects the goods to the buyer's creditors while they are on the buyer's premises. The goods will be subject to the buyer's creditors even though there is an agreement that purports to reserve title to the person making delivery until the payment or resale unless the creditor complies with one of the exceptions provided above.

The lesson for anyone contemplating consignment is clear. Even though you may not consider the shipment of inventory on consignment as an extension of credit, the safest way to do it is to comply with the filing requirements of Article 9. ❑