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## Are Your Consignments Insecure Under Uniform Commercial Code Article 9?

If the Uniform Commercial Code (“UCC”) is ignored, a customer’s creditors can gain priority over an unsuspecting consignor. The laws that govern consignment are frequently overlooked, to the consignor’s dismay. Consignments are a common means for attracting customers to take goods for possible resale when they otherwise are not willing to risk purchasing the goods for resale outright. They also are a vehicle used by manufacturers for placing components with customers who require the product on a just-in-time basis for incorporation in the customer’s products and are not willing to purchase and hold the necessary reserve component inventory. Rather than the manufacturer/producer (“consignor”) selling the goods to a customer (“consignee”) and the consignee taking the risk of selling or using the goods, in a consignment, the consignor places the goods with the consignee who is deemed to purchase the goods only if they are sold or used, and who can return unsold or unused goods to the manufacturer. Not only does the consignor have the risk the goods will remain unsold, but the consignor also risks that third parties dealing with the consignee may be misled into thinking the consignee actually owns the goods. The UCC places this risk squarely on the consignor’s shoulders with potentially disastrous consequences.

Under the UCC, a consignment is more specifically defined as the delivery of goods to a customer for the purpose of sale where the customer (i) does not deal in goods of that kind under the name of the consignor, (ii) is not an auctioneer, and (iii) is not generally known by its creditors to be substantially engaged in selling the goods of others.

The point is to encompass those situations where creditors may unwarily believe consigned goods are the property of the consignee and that the consignee therefore has greater inventory, with which to support greater debt, than it actually does. Article 9 of the UCC protects the unwary creditor by specifically designating any interest of a consignor to be a “purchase money security interest in inventory,” and endowing the consignee with all of the rights of the consignee covers the consigned goods. These provisions force the consignor to follow the protocol defined in Article 9 in order to put potential creditors on notice and protect its interest in its goods. In order to be protected against loss of priority to creditors, a party with a “security interest” (a consignor) must both create such interest by obtaining a signed security agreement and perfect its interest by filing a UCC financing statement. Moreover, the consignor must determine the correct state in which to file.

Finally, the consignee must give notice to certain creditors with pre-existing UCC filings. These requirements apply even where the agreement between the parties expressly states that the goods were to be sold “on consignment.” Strictly following the complicated rules is essential. Otherwise, the unwary consignor’s interest in its goods can be supplanted by the security interests of consignee’s creditors and the goods may be lost upon the consignee’s default. It is critical that any consignor obtain a signed security agreement, file a UCC financing statement in the correct jurisdiction, and give notice to applicable prior filers to perfect its interest in goods consigned, or risk losing them to a third party when things go awry.

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