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CLIENT ALERT

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Consignment, the UCC, and You – Protecting Your Goods *and Their Proceeds*

In a consignment distribution model, a third party Warehouse (the consignee) takes possession of goods on behalf of a Vendor (the consignor) for sale to Customers. Title passes directly from the Vendor to the Customer, and the Customer pays the Vendor directly (the Vendor pays the Warehouse a commission).[1] Despite the direct relationship between Vendor and Customer, the Ninth Circuit recently clarified that if the Warehouse files for bankruptcy, the Vendor's goods—**and any proceeds from the sale of such goods**—in Warehouse's possession can be used to pay the *Warehouse's* creditors.

The case of *IPC (USA), Inc. v. Ellis* (*In re Pettit Oil Co.*)[2] highlights pitfalls in a true consignment model: IPC delivered fuel to Pettit (the warehouse), a bulk petroleum products distributor, who then sold that fuel to customers.[3] IPC retained ownership of the fuel, customers were instructed to pay IPC directly (rather than Pettit), and IPC would pay a monthly commission to Pettit.[4] Some customers, however, mistakenly paid Pettit for the IPC fuel they purchased.[5] When Pettit filed for bankruptcy, the Trustee claimed that the IPC fuel still in Pettit's possession—**and all related money/funds customers paid Pettit instead of IPC** (as proceeds from the consigned goods)—belonged to the bankruptcy estate and could be used to satisfy the claims of Pettit's creditors.[6]

The Ninth Circuit's decision hinged on two related issues. First, the Uniform Commercial Code (UCC) "treats the consignee as having an ownership interest."[7] This ownership interest is sufficient to bring any consigned goods into the consignee's/warehouse's bankruptcy estate. Crucially, the Ninth Circuit explicitly held that within the UCC context, consigned goods include proceeds (such as cash and accounts receivable) from the sale of those goods as long as they are held by the consignee.[8]

Second, once the goods and their proceeds were determined to be within the bankruptcy estate, the Ninth Circuit had to determine who had the superior right: the Vendor/Owner (IPC) or the creditors of the Warehouse (Pettit).

Article 9 of the UCC governs the priority and perfection rules related to security interests in goods (which can include agricultural products), and the UCC "treats a consignment as a security interest for all practical purposes."[9] Retention of title affects the types of remedies available to consignors (like IPC) in their efforts to recover goods after a default, but the Ninth Circuit explained: "title is irrelevant to whether IPC or the Trustee has a priority in the goods and proceeds."[10] Ultimately, because the UCC treats Pettit (the consignee) as having an "ownership interest" and IPC (the consignor) as having a "security interest"—and IPC (admittedly) never perfected that security interest—the Trustee prevailed.[11]

Consignors should take the necessary steps under the UCC to perfect their interests in consigned goods. Growers, manufacturers, and other producers should work closely with their attorneys to identify the proper distribution model to use. If a consignment model is selected then the consignor should take all necessary steps to protect its interests and avoid bankruptcy pitfalls.

References and Citations

[1] 5 Collier on Bankruptcy ¶ 541.05[1][b] (16th ed.) (2018).
[2] *IPC (USA), Inc. v. Ellis* (*In re Pettit Oil Co.*), Case No. 17-60081 (9th Cir. March 11, 2019).
[3] *Id.* at *4.
[4] *Id.* at *4.
[5] *Id.* at *4.
[6] *Id.* at *5.
[7] *Id.* at *6.
[8] *Id.* at *8.
[9] *Id.* at *7 (citing UCC §§ 1-201(b)(35), 9-102(a)(73)(C), 9-102(a)(12)(C), 9-319(a), and 9-324(b)).
[10] *Id.* at *8 (citing UCC § 9-202, cmt. 3.a.).
[11] *Id.* at *7.

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