**Special Attachment Rules I:** **Retention of Title and Consignments**

Welcome to this podcast on Special Attachment Rules I: Retention of Title and Consignments brought to you by CALI. I’m Professor Jennifer S. Martin. This podcast is the first of two podcasts that focus on when a security interest attaches to collateral under Article 9 due to the nature of the transaction even where there’s not an explicit statement granting a security interest.

Let’s begin with the nature of a security interest. A security interest is defined in § 1-201(35) as “an interest in personal property or fixtures which secures payment or performance of an obligation.” In the ordinary case, a creditor goes about creating a security interest in the collateral by complying with the requirements of § 9-203, which makes a security interest enforceable only if three elements are present: (1) *value* has been given (most of the time this is the same as consideration -- the money or goods given or promised by the creditor); (2) the *debtor has rights* in the collateral or power to transfer rights in the collateral to a secured party (meaning some form of property right to the personal property); and (3) there is some proof that the debtor has entered into a security agreement. When the last of these three things occurs, the security interest attaches and becomes enforceable, and the creditor can foreclose if there is a default.

Recall, however, that Article 9 applies to transactions that create security interests “regardless of form.” See § 9-109(a)(1). In this podcast we will focus on two types of transactions that might not satisfy § 9-203’s elements but nevertheless create a security interest. These transactions create a security interest due to the *form of the transaction*: retention of title and consignments. Notably, leases that are not true leases can also fall in this category of transactions that create a security interest due to the form of the transaction, but leases are covered in another podcast. Other transactions, such as sales of accounts, chattel paper, promissory notes and payment intangibles that are specifically included in Article 9, even though they are not typical secured transactions, will be covered in another podcast.

Let’s begin with retentions of title, which are sometimes referred to as conditional sales contracts. The traditional Article 9 transaction supposes that the secured creditor takes a security interest in collateral in which the debtor has rights. In a conditional sales contract, the buyer of goods signs an agreement that specifically provides that the seller “retains title” to the goods until the buyer has paid the price in full. By using this type of clause, a seller probably intends to be able to reclaim the goods if the buyer fails to pay. Article 9 accomplishes this goal, since the essence of the retention of title is to create a security interest and, as such, these devices are within the definition of a security interest and are governed by Article 9. This is the case even though the agreement providing for the retention of title does not explicitly provide for the granting of a security interest. It is a security device nevertheless.

Section 2-401 explains that even where a seller obtains a security interest, title to goods passes to the buyer when the seller delivers the goods to the buyer. Moreover, even if a seller purports to retain title to goods, any attempt to do so is limited to a reservation of a security interest. Section 9-109 specifically states that security interests created under § 2-401 are within the scope of Article 9. In retention of title cases, the seller typically has given value to the buyer (the goods) and the buyer now has rights to them (the buyer now has title). The outstanding issue under § 9-203 would be whether there is a need for an authenticated security agreement. So long as the sales contract that retains title is authenticated by the buyer, there is no need for a traditional security agreement. Title to the goods will transfer to the buyer and the seller will have a security interest in the goods.

Let’s look at several examples.

Example 1. Martin wanted to buy a clarinet for her son Marshall. Music City agreed to sell her the clarinet and Marshall took delivery of the instrument. The parties signed a sales contract providing that Martin would pay the price over three years and that Music City would “retain title” to the clarinet until Martin paid in full. Despite the reservation of title, title to the clarinet passed to Martin pursuant to § 2-401. Music City has retained a security interest in the clarinet which is governed by Article 9. There is no need for a formal security agreement as § 2-401 provides for the creation of the security interest.

Example 2. Music City agreed to purchase monthly shipments of instruments for resale from Supplier pursuant to a sales contract which provided Music City would pay for each shipment within thirty days of delivery and Supplier would retain title to the instruments until Music City paid. Supplier made shipments of instruments in January and February, for which it has not been paid. Supplier is preparing the March shipment, but it has not been shipped or delivered to Music City. Despite the reservation of title, title to the January and February shipment of instruments passed to Music City pursuant to § 2-401. Supplier has a security interest in the January and February shipments and it is governed by Article 9. There is no need for a formal security agreement as § 2-401 provides for the creation of the security interest. As to the March shipment, Supplier still has title because there has not been a shipment or delivery to the buyer.

Example 3. Same facts as Example 2, except First Bank has a security interest in the inventory, including after acquired inventory, of Music City. Due to the retention of title, Supplier will have a security interest in the January and February shipments to Music City. However, First Bank will also have a security interest in the January and February shipments to Music City as Music City has rights to the shipment under § 2-401 when title passed to it. As to the March shipment, since Supplier still has title, First Bank’s security interest has not attached to this shipment.

Let’s turn to consignments. Some consignments, like retention of title transactions, fall within the definition of a security interest and are governed by Article 9 even though they don’t explicitly provide for a granting of a security interest. In general, a consignment arises when a person delivers goods to a merchant for the purpose of sale without transferring ownership to the goods. As such, the goods are not inventory of the merchant, but are rather consigned by the owner for sale by the merchant. For purposes of Article 9, the person consigning the goods is the consignor and the merchant is the consignee. Accordingly, like entrustment transactions, consignments do not operate to transfer title to the goods. Consignments valued over $1000 at the time of delivery are governed by Article 9 so long as (1) the goods were not consumer goods before the consignment, (2) the consignment does not create a security interest otherwise, and (3) the merchant is not the same person making delivery, an auctioneer, or known to sell the goods of others. For purposes of Article 9, the consignor is the secured party with a security interest in the goods and the consignee is the debtor.

Let’s look at some examples.

Example 4. Old Time Car Museum agrees to sell at its gift shop on consignment $5000 worth of gas station antiques that are owned by Carlos. Old Time and Carlos execute an agreement stating that the antiques are owned by Carlos and only placed on consignment with Old Time which will earn a 25% commission for selling the antiques. This consignment transaction is a security interest because the goods are over $1000, are not consumer goods prior to the consignment, and Old Time is not an auctioneer or known to be selling the goods of others. Carlos would be the secured party with a security interest in the antiques and Old Time would be the debtor.

Note that the significance of this rule is that it is likely that Old Time has also granted a security interest in its inventory to a creditor. If that creditor forecloses on the collateral, it is likely to foreclose on the consignor’s goods unless the consignor takes steps to give its security interest priority. The exceptions, where the consignor is protected from other creditors, are illustrated in the following examples.

Example 5. Same facts as Example 4, except the antiques delivered are valued at only $750. The transaction would not be governed by Article 9 because the value of the goods is under $1000.

Example 6. Same facts as Example 4, except that the gift shop at Old Time has a sign posted “Antiques on Consignment.” In this case, Old Time would be known to be selling the goods of others, so the transaction would not be governed by Article 9.

Example 7. Jade takes a bag of used designer clothes to a resale shop that takes the items on consignment, agreeing to pay Jade if the items sell. The consigned items are consumer goods prior to the consignment, so this is not an Article 9 consignment.

At this point, you should be able to describe and identify two types of transactions that create security interests even though the parties don’t explicitly provide for one: retention of title and consignments. Despite a seller’s attempt to retain title to goods sold, title still transfers to a buyer and the seller retains a security interest. While a consignment does not transfer title to the merchant who is charged with selling the goods, the merchant is a debtor and the consignor has a security interest so long as the transaction meets the requirements of Article 9.

I hope you’ve enjoyed this podcast on Special Attachment Rules I.

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