

A PICTURE IMPERFECT: THE RIGHTS OF ART CONSIGNOR- COLLECTORS WHEN THEIR ART DEALER FILES FOR BANKRUPTCY

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ABSTRACT

Bankruptcy law allows third-party creditors of a consignee to attach consigned property in the consignee's possession when the consignee declares bankruptcy unless a consignor has acted to perfect a security interest in the consigned goods by complying with commercial law requirements. The drafters of the Uniform Commercial Code (UCC) provided for attachment because they wanted to protect third-party creditors from the unwelcome surprise of hidden liens dominating claims to a consignee's property in bankruptcy. Applying this attachment policy overly broadly in the art consignment context creates problems, though, because opportunistic creditors can use the attachment procedure despite having full knowledge of the widespread practice of consignment in the art industry. In 2001, the drafters revised the UCC with the desire to clarify consignment issues as part of the revision. Courts continue to struggle, however, with analyzing issues of consignment in bankruptcy. This Note argues that because art consignment stands apart from other types of consignment, the law should not require art consignor-collectors to follow UCC filing requirements to protect their artwork from attachment by third-party creditors, who are acutely aware of the risk that a consignee art dealership is substantially dealing in consigned artwork. Further, it suggests that courts should presume that art dealerships are generally known to be

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substantially selling in consigned work. Once consignors show that an art dealership is generally known to be substantially selling in consigned work, courts should exempt consigned artwork from the bankruptcy estate. This Note also proposes extending the statutory protection afforded to consignor-artists to consignor-collectors.

INTRODUCTION

As security guards seized masterpieces from the famed Berry-Hill gallery, the public got a glimpse into the “often-byzantine financial maneuvering”¹ of the art world. Berry-Hill, a prominent New York gallery, had filed for bankruptcy in federal court.² The art world was dismayed by news that Berry-Hill had outstanding debts as large as \$50 million.³ As the dust settled, artists and collectors who had consigned work to Berry-Hill began to realize what the bankruptcy filing meant for their artwork. The pieces they had consigned to Berry-Hill to sell on their behalf might be “trapped in bankruptcy court purgatory” for months.⁴ Some observers wondered how savvy businesspeople, accustomed to protecting their assets, had been so cavalier.⁵ Consigning artwork was a pervasive practice in New York galleries, and questions lingered about why no one was protecting these consignors.⁶

Less than two years later, a familiar scene played out when another premier New York gallery, Salander-O’Reilly, filed for bankruptcy.⁷ Some collectors charged Salander with selling consigned

1. Carol Vogel, *Gallery Under Legal Fire Declares Bankruptcy*, N.Y. TIMES, Dec. 22, 2005, at E1.

2. David Hewett, *Berry-Hill Galleries: Bankruptcy’s Tentacles Spread*, ME. ANTIQUE DIG., Feb. 2006, http://maineantiquedigest.com/articles_archive/articles/feb06/berryhill0206.htm.

3. Vogel, *supra* note 1.

4. See John Dizard, *Paint Peels on a Genteel Market*, FT.COM, June 23, 2006, <http://www.ft.com/cms/s/2/f8dc4f00-02c4-11db-9231-0000779e2340.html> (discussing the purgatory-like effect of Berry-Hill’s bankruptcy on the painting “Kids” by George Bellows).

5. *Id.* (“Otherwise hard-nosed customers, who in their day jobs would never ship around assets of their own companies without documentation, failed to file what are known as UCC notices (chattel mortgages in the UK) on their property. These would have secured their ownership of the property.”).

6. David Hewett, *The Berry-Hill Bankruptcy: Biggest Problem Solved but Still Some Uncertain Waters to Navigate*, ME. ANTIQUE DIG., Mar. 2006, http://maineantiquedigest.com/articles_archive/articles/mar06/berryhill0306.htm.

7. James Barron & Patrick McGeehan, *Big Dreams, Big Expenses: In a Lavish Town House, an Art Gallery in Trouble*, N.Y. TIMES, Oct. 29, 2007, at B1.

artwork and then failing to pay them their due proceeds.⁸ Collectors were not the only parties with bankruptcy claims against the gallery.⁹ Salander was inundated by a “cascade of lawsuits” from concerned creditors.¹⁰ As with Berry-Hill, consigned work and consignment proceeds were caught up in bankruptcy proceedings.¹¹ Among these claimants were artists’ heirs, an emissary from the Italian prime minister seeking a painting of St. John the Baptist, and the Indianapolis Museum, which had loaned Salander a prized Caravaggio.¹² Presented with competing claims over assets and confusion about title to many of the works, a state court judge ordered the gallery locked and “effectively shut [it] down.”¹³

The precarious position of the Berry-Hill and Salander consignors in bankruptcy resulted from the curious treatment of consigned goods in bankruptcy. After its revision in 2001, most consignment transactions are governed by Article 9 of the Uniform Commercial Code (UCC).¹⁴ Under UCC section 9-319, if the consignor’s security interest is unperfected, then “for purposes of determining the rights of creditors of . . . a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.”¹⁵ This effectively means that if the consignor does not have a perfected security interest in an artwork,

8. Philip Boroff, *Bankruptcy Judge Denies Salander’s Request for Job at Gallery*, BLOOMBERG.COM, Feb. 28, 2008, http://www.bloomberg.com/apps/news?pid=20601088&sid=aitx5_a6joVE&refer=muse (“Artists, heirs and collectors, including hedge fund manager Roy Lennox of Caxton Associates, have alleged that the dealer [Salander] sold art on consignment without remitting proceeds . . .”).

9. *Drama on East 71st Street*, ARTNET NEWS, Oct. 17, 2007, <http://www.artnet.com/magazineus/news/artnetnews/artnetnews10-17-07.asp> (“Other prominent litigants have been lining up since late spring. According to reports, Salander is being sued by artist and former *New York Observer* publisher Arthur Carter for nonpayment, and by former tennis star John McEnroe for failing to double a \$162,500 investment in five months.”).

10. James Barron, *A Gallery’s Money Crisis, and Shaken Trust*, N.Y. TIMES, Nov. 7, 2007, at B2.

11. Philip Boroff, *Salander-O’Reilly Gallery Can Borrow \$870,000, Judge Rules*, BLOOMBERG.COM, Jan. 4, 2008, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aobQyQnXZvsc>.

12. Anemona Hartocollis, *Art Gallery Is Target as Dozens Go to Court*, N.Y. TIMES, Oct. 20, 2007, at B1.

13. James Barron, *Judge Shuts Down Art Gallery as Lawsuits Multiply*, N.Y. TIMES, Oct. 19, 2007, at B1.

14. George H. Singer & Michael P. Warren, *The ABCs of the New UCC: How to Consign Under Revised Article 9*, BENCH & B. MINN., Mar. 2005, at 28, 28.

15. U.C.C. § 9-319 (2008).

third-party creditors may attach consigned artwork in a consignee's bankruptcy proceedings.¹⁶ If the consignor has a perfected security interest, the consignor would be able to claim superpriority in the consignor's interest to the artwork over all third-party creditors.¹⁷ Therefore, determining whether the consignor's security interest is perfected is critical to deciding parties' bankruptcy rights to the collateral.

Article 9 gives consignors an automatic purchase-money security interest in inventory,¹⁸ and courts would likely consider paintings to be inventory.¹⁹ If perfected, a purchase-money security interest offers its holder something of a golden ticket.²⁰ Subject to a few exceptions, purchase-money security interest holders take priority over all other claimants in bankruptcy.²¹ To reap the benefits of superpriority, consignors must still perfect their purchase-money security interest to avoid having their work seized in a consignee's bankruptcy.²² Consignors most commonly perfect purchase-money security interests by filing a UCC-1 financing statement.²³ In the art world, which at times seems allergic to paperwork, parties often do not fill out UCC

16. See Mark R. Owens & Gary M. Hoke, *Lien on Me: Navigating the Consignment Rules Under UCC Article 9*, AM. BANKR. INST. J., Oct. 2006, at 24, 24 ("Generally, if the consignee under such a consignment arrangement files for bankruptcy relief, the consigned goods are property of the consignee's bankruptcy estate.").

17. U.C.C. § 9-317(a).

18. *Id.* § 9-103(d).

19. See *id.* § 9-102(a)(48)(B) (defining "inventory" as goods "held by a person for sale or lease or to be furnished under a contract of service"). *But see In re Haley & Steele, Inc.*, No. 051617BLS, 2005 WL 3489869, at *3 (Mass. Dist. Ct. Nov. 14, 2005) ("[T]o the extent that those persons listed . . . as 'consumer consignors'—as opposed to 'commercial consignors'—are persons whose goods consisted of artwork that was used or bought for use primarily for personal, family, or household purposes immediately before delivery to Haley & Steele, then their artwork falls outside of the 'consignment' defined in sec. 9-102(20).").

20. See U.C.C. § 9-324(a) ("[A] perfected purchase-money security interest in goods . . . has priority over a conflicting security interest in the same goods.").

21. *Id.*

22. Ingrid Michelsen Hillinger & Michael G. Hillinger, *2001: A Code Odyssey (New Dawn for the Article 9 Secured Creditor)*, 106 COM. L.J. 105, 114 (2001).

23. Security interests can also be perfected by possession, U.C.C. § 9-313, and by the holder having what Article 9 deems as "control" over the special categories of collateral, *id.* § 9-314. Because the consignor delivers the painting to the consignee, and thus gives possession to the consignee, possession would likely be an impracticable method of perfection. Perfection by control applies only to "investment property, deposit accounts, letter-of-credit rights, or electronic chattel paper." *Id.* § 9-314(a). A security interest in artwork does not fall into any of these categories.

forms.²⁴ Without filing a UCC-1 financing statement, the art consignor's security interest may remain unperfected.²⁵ If the consignor's security interest is unperfected and the consignee files for bankruptcy, the consigned property is deemed property of the bankruptcy estate.²⁶ Instead of getting possession of the artwork, the consignor merely stands as a creditor with an unperfected security interest.²⁷

The policy rationale behind allowing third-party creditors to claim rights to consigned property was that the drafters of the UCC did not want third parties to be harmed by "hidden liens" on a debtor's property.²⁸ But the risk of third-party creditors being shocked by hidden liens on consigned artwork in a gallery's inventory is less convincing than in other industries. Consignment is a common practice in the art world.²⁹ Third-party creditors of an art gallery should arguably be aware that some of the gallery's inventory consists of consigned work. Because consignment is a widespread practice in the art industry, there is less reason to think creditors would be susceptible to hidden liens.

The difficulty with the UCC's treatment of art consignment is that "the law treats the consignment of art to the gallery the same way [it] would treat the consignment of screwdrivers to a shop."³⁰ The consignment of art, however, involves issues not contemplated in the

24. See TAD CRAWFORD & SUSAN MELLON, *THE ARTIST-GALLERY PARTNERSHIP: A PRACTICAL GUIDE TO CONSIGNING ART* 29 (1998) (commenting on the UCC filing form often being "an unrealistic measure" because of an aversion to completing the paperwork required for a UCC financing statement).

25. See Owens & Hoke, *supra* note 16, at 24 ("[T]he consignor may proactively protect its rights in the consigned goods by perfecting its purchase-money security interest in the consigned goods that UCC § 9-103(d) creates. To perfect its security interest, the consignor must file an appropriate UCC financing statement.").

26. *Id.*

27. See Gary D. Spivey, *Consignment Transactions Under the Uniform Commercial Code*, 40 A.L.R.3d 1078, 1086 (1971) ("Article 9 subordinates an unperfected security interest to the claims of certain lien creditors . . . general creditors often will be able to defeat the unperfected security interest of the consignor . . .").

28. U.C.C. § 2-326 cmt. 2 (2000) ("The purpose of the exception is merely to limit the effect of the present subsection itself . . . to cases in which creditors of the buyer may reasonably be deemed to have been misled by the *secret reservation*." (emphasis added)); see also Cantor v. Anderson, 639 F. Supp. 364, 369 (S.D.N.Y. 1986) ("The purpose of U.C.C. § 2-326 is to protect creditors of a consignee of goods from hidden liens.").

29. CRAWFORD & MELLON, *supra* note 24, at 3.

30. *A Dealer and Collector Describes His Experiences with Berry-Hill*, ME. ANTIQUE DIG., Mar. 2006, http://maineantiquedigest.com/articles_archive/articles/mar06/t-berryhill2-0306.htm (quoting the Hon. Joseph P. Carroll).

consignment of screwdrivers. Whereas the value of a screwdriver can be judged according to the broader general market for screwdrivers, the value of a unique piece of artwork depends on an “inherently subjective process.”³¹ Also, hardware stores’ norms of accounting and filing are likely more geared toward UCC filing than the “handshake agreement” culture of the art world.³²

In light of the art market’s unique demands, this Note suggests developing a bankruptcy policy that responds to the distinctive features of art consignment. Part I describes courts’ historical confusion in analyzing consignment transactions in bankruptcy and the failure of the 2001 UCC revisions to fully remedy this confusion. Part II discusses how several states have responded to flaws regarding how the UCC handles consignment by enacting statutes to protect artist-consignors when dealers declare bankruptcy. Part III examines the lack of comparable protection for collector-consignors. Finally, Part IV reconsiders the treatment of collector-consignors when their art dealership files for bankruptcy and recommends measures to safeguard collectors’ rights to their artwork. Possible ways to mold a consignment-bankruptcy policy that responds to the unique features of art consignment include creating a presumption that art dealers are generally known to be selling consigned art. Moreover, showing that art dealerships are known to sell consigned art should exempt consigned paintings from the bankruptcy estate. Additionally, state statutory protections for artist-consignors should be extended to consignor-collectors.

I. THE HISTORY OF CONSIGNMENT IN BANKRUPTCY

Consignment under bankruptcy law is something of an anomaly in the law, in part because consignment involves the overlapping sources of the laws of agency and bankruptcy. Courts have defined the consignment relationship broadly: A consignment sale occurs when a “merchant takes possession of goods and holds them for sale with the obligation to pay the owner for the goods from the proceeds

31. See John G. Steinkamp, *Fair Market Value, Blockage, and the Valuation of Art*, 71 DENV. U. L. REV. 335, 338 (1994) (“Valuation of artworks, however, offers no such ease or certainty. Artworks are not fungible; each is unique. Sales of the particular work to be valued, or of comparable pieces, may occur infrequently. . . . [V]aluation of art is an inherently subjective process and experts’ opinions often vary dramatically.” (citations omitted)).

32. See Anthony Haden-Guest, *Art Scandal: Art World Shake-Up?*, FORBES.COM, Feb. 14, 2001, <http://www.forbes.com/2001/02/14/0213artfraud4.html> (describing the handshake culture of art dealers).

of a sale by the merchant. If the merchant does not sell the goods the merchant may return the goods to the owner without obligation.”³³ When a consignor delivers goods to the consignee, despite vesting the consignee with the rights to sell the goods, title remains with the consignor.³⁴

An agency relationship accompanies a consignment relationship.³⁵ The consignor acts as the principal and the consignee serves as the agent.³⁶ Under agency law, when the consignor appoints the consignee as an agent, the consignee has fiduciary duties to act with “the utmost good faith, loyalty, and honesty toward the principal.”³⁷ Inherent in the agent’s duties of good faith and loyalty is an obligation to prioritize the principal’s interests over the agent’s own interests.³⁸

Whereas the agency relationship in consignment gives the consignor rights to the consignee’s good faith and fiduciary duties, the consignor receives somewhat counterintuitive treatment in bankruptcy. In bankruptcy law, a priority system determines which of the insolvent party’s creditors will receive access to portions of the bankruptcy estate.³⁹ In order of descending priority are, first, secured creditors with perfected interests, second, secured creditors with unperfected security interests, and third, general unsecured creditors.⁴⁰ When a consignee files for bankruptcy, creditors may

33. See, e.g., *Bank of Cal. v. Thornton-Blue Pacific, Inc.*, 62 Cal. Rptr. 2d 90, 94 (Ct. App. 1997) (defining the trigger of a consignment relationship by the delivery of goods to a merchant with the understanding that the merchant will sell the goods on the consignor’s behalf and remit the proceeds, and not by formalistic contract language).

34. Bruce S. Nathan, *Consignment the Wrong Way or How to Become Last in Line*, AM. BANKR. INST. J., Nov. 2002, at 14, 14.

35. See CRAWFORD & MELLON, *supra* note 24, at 4 (“Each party in the consignment relationship makes a serious commitment to the other. Consigning artists give up a measure of control over their creations, entrusting them to an agent whose business is the marketing of artworks.”).

36. See *id.* at 61 (“When it is deemed that a consignment relationship exists between the artist and the gallery, the gallery is then statutorily considered the agent of the artist.”).

37. 3 AM. JUR. 2D *Agency* § 205 (2002).

38. RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b (2006) (“Although an agent’s interests are often concurrent with those of the principal, the general fiduciary principle requires that the agent subordinate the agent’s interests to those of the principal and place the principal’s interests first as to matters connected with the agency relationship.”).

39. 11 U.S.C. §§ 506–07 (2006); see also U.C.C. § 9-322(a)(1) (2008) (“Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection.”).

40. See 11 U.S.C. §§ 506–07 (stating the bankruptcy code’s rules regarding creditors secured interest claims and priorities in bankruptcy); U.C.C. § 9-322(a)(1) (stating the general

attach the property in the consignee's possession.⁴¹ Under Article 9 of the UCC, if a consignor has not taken efforts to file the consignor's interest in the consigned property, the consignor will stand as a creditor with an unperfected security interest in the bankruptcy action.⁴²

Some may find this result counterintuitive. In many cases, consignors transfer their property into a consignee's control so the consignee can sell the property. The parties understand that the consignee will keep a percentage of the sale proceeds as a commission.⁴³ In bankruptcy law, however, the consignor's status often becomes that of a "general unsecured creditor."⁴⁴ This status does not entitle the consignor to the entirety of the proceeds from the sale of consigned items. Many times, the consignor in bankruptcy is unable to directly claim the proceeds arising from the sale of the consigned property. Instead, the consignor joins the pool of creditors with unperfected security interests.⁴⁵

This Part traces the UCC's past methods of dealing with consignment in bankruptcy under section 9-114 and section 2-326, detailing the UCC's requirements that consignors either file a UCC financing statement or prove that the consignee was "generally known by his creditors to be substantially engaged in selling the goods of others" in order to have a superior claim to the consignors' consigned property.⁴⁶ The UCC's history informs an examination of consignor-collectors' continuing problems, following the revision of the UCC in 2001, with regaining possession of their work in bankruptcy.

rules that govern priority: perfected security interests have priority over unperfected security interests, and conflicting perfected security interests "rank according to priority in time of filing or perfection").

41. See Owens & Hoke, *supra* note 16, at 24 (noting that when a consignee files for bankruptcy, "consigned goods are property of the consignee's bankruptcy estate," meaning consigned goods can become subject to creditor claims as creditors attempt to settle the consignee's outstanding debts).

42. See *id.* ("The typical consignor is relegated to the status of a general unsecured creditor.").

43. 32 AM. JUR. 2D *Factors and Commission Merchants* § 18 (2007).

44. Owens & Hoke, *supra* note 16, at 24.

45. *Id.*

46. U.C.C. § 2-326 (2000).

A. *The UCC's Past Method for Dealing with Consignments*

Prior to 2001, Article 9 or UCC section 2-326 regulated consignment agreements between collectors and dealers.⁴⁷ When a transaction was a “consignment . . . intended as security” in the consigned goods, it fell under Article 9.⁴⁸ For consignors to receive priority over third-party creditors, consignors were obliged to file and perfect their security interests in the consigned goods.⁴⁹ To perfect their security interests, Article 9 required consignors to file a UCC-1 financing statement.⁵⁰ Section 9-114 also imposed a number of notification requirements to alert other security holders of the collateral that the consignor had a consignment interest in the property.⁵¹

UCC section 2-326 regulated consignments determined to be “sale or return” transactions.⁵² Section 2-326(3) provided that when goods were transferred to a person for sale and that individual operated a business selling goods of that kind “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.”⁵³ Section 2-326(3) operated even when the parties used explicit terms like “*on consignment*” in their agreement.⁵⁴ Under section 2-326, if an art dealer declared bankruptcy while consigned artwork was in the dealer’s custody, creditors might be able to claim rights to the work or its proceeds.⁵⁵ Therefore, section 2-326 could have punitive results for a consignor. Though the consignor entered into an agreement with the consignee that the consignee would either sell the painting and then distribute an agreed-upon share to the consignor or return the painting, the

47. See Mark Marcone, Note, *The UCC and Consignment: Making the Code Safe for Artists and Other “Little Fellows,”* 12 CARDOZO ARTS & ENT. L.J. 579, 597–602 (1994) (discussing the UCC’s treatment of consignment transactions in 1994).

48. *Id.* at 597.

49. Nathan, *supra* note 34, at 14.

50. U.C.C. § 9-114 (stating that “[a] person who delivers goods under a consignment which is not a security interest and who would be required to file under this Article by paragraph (3)(c) of Section 2-326” would be able to secure priority over other claiming creditors by filing a financing statement).

51. *Id.*

52. *Id.* § 2-326.

53. *Id.* § 2-326(3).

54. *Id.*

55. *Id.* § 2-326(2).

consignor's claim against the consignee merely joined the other unsecured creditors in bankruptcy.

There were three exceptions to section 2-326(3)'s reach in "sale or return" transactions. The two significant exceptions with respect to art consignments are subpart (b), which exempted consignors who "establishe[d] that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others,"⁵⁶ and subpart (c), which excluded transactions that followed the security filing requirements of Article 9.⁵⁷ Though the "generally known by his creditors to be substantially engaged in selling the goods" exemption might seem like a panacea for a consignor who consigned to a dealership that sold a considerable amount of artwork belonging to others, winning the exemption was not problem free.⁵⁸

The UCC comments helped shed light on the drafters' interpretation of the "generally known" exception, stating that the exception applied to debtors "*primarily*" engaged in selling the goods of others.⁵⁹ First, under section 2-326(3), the consignor bore the burden of proving that a dealership was "generally known by his creditors to be substantially engaged in selling the goods of others."⁶⁰ Second, courts have required consignors to prove that "*most*" of the debtor's creditors were aware that the creditor was substantially selling the goods of others.⁶¹ Courts have not been sympathetic to mere evidence that a debtor was significantly selling consigned goods, which might lead to an inference that a consignor was generally known.⁶²

56. *Id.* § 2-326(3)(b).

57. *Id.* § 2-326(3)(c). The third exception, found in subpart (a), exempted consignors who "comple[d] with an applicable law providing for a consignor's interest or the like to be evidenced by a sign." *Id.* § 2-326(3)(a).

58. See CRAWFORD & MELLON, *supra* note 24, at 58 (noting that proving the generally known exception may be "difficult and costly to prove").

59. U.C.C. § 2-326 cmt. 2 (emphasis added); see also *id.* ("A necessary exception is made where the buyer is known to be engaged primarily in selling the goods of others . . .").

60. *In re* BRI Corp., 88 B.R. 71, 74-75 (Bankr. E.D. Pa. 1988) ("The burden of proving compliance with one of the exceptions outlined in Section 2326(c) of the U.C.C. is on the consignor.").

61. See, e.g., *id.* at 75 (maintaining vigorously the standard that the consignor must prove the knowledge of "most" of the debtor's creditors, and rejecting as insufficient evidence that approximately 40 percent of creditors, or what the court characterized as "some" of the creditors, knew that the consignee was substantially selling consigned goods).

62. See *Quaker City Iron Works, Inc. v. Ganz (In re Wicaco Mach. Corp.)*, 49 B.R. 340, 344 (Bankr. E.D. Pa. 1984) (holding that though one-fifth of creditors had "actual knowledge" of

Courts' application of the generally known exception has been uneven.⁶³ In *In re Alper-Richman Furs*,⁶⁴ a court denied summary judgment on whether a consignee was generally known when 79 percent of the unsecured claims against the consignee were by an affiliated company with strong ties to the consignee and well acquainted with the consignee's consignment practices.⁶⁵ In *General Electric Credit Corp. v. Strickland Division of Rebel Lumber Co.*,⁶⁶ the debtor had a flashing sign outside of his business announcing that he sold the goods of others. He also publicized that he sold goods of others in radio advertisements.⁶⁷ The court found that the debtor was generally known by creditors to sell the goods of others, and, having proven the generally known exception, the consignor won his claim to

the debtor's consignment practices, which amounted to 63 percent of the claims against the debtor, other creditors were not sufficiently aware of the debtor's consignment because "[s]ection 2326(c)(2) . . . does not refer to the amount of the indebtedness, but to the creditors"; see also *Steege v. Affiliated Bank/N. Shore Nat'l (In re Alper-Richman Furs, Ltd.)*, 147 B.R. 140, 150–51 (Bankr. N.D. Ill. 1992) (seeking evidence of what other outside creditors knew about the debtor's consignment practices, despite the fact that claims of the affiliated debtor's company and employees of that company comprised 79 percent of unsecured claims against the debtor).

63. See *In re Griffin*, 1 U.C.C. Rep. Serv. (CBC) 492 (Bankr. W.D. Pa. 1960) (holding that a furniture company's sign gave sufficient notice that the company sold the goods of others when the sign stated that the company sold used furniture and its mention of "cleaning and moth proofing of furniture and rugs obviously could only refer to personal property of others than the owner of the business"); *Gen. Elec. Credit Corp. v. Strickland Div. of Rebel Lumber Co.*, 437 So. 2d 1240, 1245 (Ala. 1983) (upholding the lower court's determination that a debtor was generally known to be selling consigned goods when the debtor promoted selling goods for others on the radio, had a flashing sign that declared that he sold goods for others, and a complaining creditor knew that the debtor sold goods for others). But see *In re Valley Media, Inc.*, 279 B.R. 105, 132 (Bankr. D. Del. 2002) (holding that even if creditors knew about consignment, Valley Media's 17 percent consignment level did not rise to a substantial enough level to meet the generally known exception); *In re Alper-Richman Furs, Ltd.*, 147 B.R. at 149–50 (denying summary judgment when claims of the affiliated debtor's company and employees of that company held 79 percent of the total unsecured claims and seemingly had knowledge of debtor's practice of consignment, instead requiring additional evidence about what other outside creditors knew about the debtor's consignment practices); *Multibank Nat'l of W. Mass., N.A. v. State St. Auto Sales, Inc. (In re State St. Auto Sales, Inc.)*, 81 B.R. 215, 218 (Bankr. D. Mass. 1988) (holding that even though the largest creditor knew of the debtor's consignment of cars, including the cars at issue in the case, this did not satisfy the generally known exception because the debtor consigned only a few cars each year and most creditors were not aware of the debtor's consignment business).

64. *Steege v. Affiliated Bank/N. Shore Nat'l (In re Alper-Richman Furs, Ltd.)*, 147 B.R. 140 (Bankr. N.D. Ill. 1992).

65. *Id.* at 149–50.

66. *Gen. Elec. Credit Corp. v. Strickland Div. of Rebel Lumber Co.*, 437 So. 2d 1240 (Ala. 1983).

67. *Id.* at 1245.

the property.⁶⁸ In addition, even in the absence of a showing that the consignee's business met the generally known exception, some courts have denied a third-party creditor's claim to consigned property if the opposing party can show that the creditor had actual knowledge of the consignment situation.⁶⁹

The art market adds a unique wrinkle to determining the applicability of the generally known exception to art dealerships.⁷⁰ Many art dealerships feature a number of different works of art from multiple sources. Dealerships sometimes showcase work that is on loan to the dealership, work that the dealership itself owns and is up for sale, and work that the dealership is selling on consignment.⁷¹ Though consignors could make a strong argument that a particular dealership is generally known by its creditors to be selling goods of others, a creditor may argue that because the dealership showcases items that are not consignment items, its consignment sales are not substantial enough to prove that the dealer is generally known to sell consignment items.⁷²

B. *The 2001 UCC Revision*

The UCC was revised in 2001 with the hope that the changes would clarify a number of issues, including consignment.⁷³ Revisions

68. *Id.*

69. See *GBS Meat Indus. Pty. Ltd. v. Kress-Dobkin Co.*, 474 F. Supp. 1357, 1363 (W.D. Pa. 1979) ("The clear import of the comments to § 2-326, and the judicial precedents discussed above establish that, where a secured creditor knows that the proceeds rightfully belong to a consignor, the consignor must have priority."); *Belmont Int'l, Inc. v. Am. Int'l Shoe Co.*, 831 P.2d 15, 19 (Or. 1992) (en banc) ("In a dispute between a consignor and a creditor of the consignee as to priority in the consigned goods, proof that the creditor actually knew of the consignment before becoming a creditor is sufficient to meet the requirements of ORS 72.3260(3)(b) [Oregon's statute adopting UCC section 2-326].").

70. See *CRAWFORD & MELLON*, *supra* note 24, at 58 (noting that, for artists, requirement that "the gallery's dealings were known to the creditor . . . may be difficult and costly to prove").

71. See, e.g., Hoovers.com, Industry Profile: Art Dealers and Galleries, <http://premium.hoovers.com/subscribe/ind/fr/profile/basic.xhtml?ID=356> (last visited Jan. 1, 2009) ("Some exhibitions incorporate loaned art to provide additional works by the same artist or related works from the period."); see also *CRAWFORD & MELLON*, *supra* note 24, at 5 (noting that galleries have varied practices in the relative proportion of artwork that is consigned and the proportion the gallery itself owns).

72. See U.C.C. § 2-326(3)(b) (2000) (stating the requirement that a consignor prove that the consignee was "generally known by his creditors to be substantially engaged in selling the goods of others").

73. See, e.g., *Robbins v. Comerica Bank-Detroit (In re Zwagerman)*, 115 B.R. 540, 548 n.4 (Bankr. W.D. Mich. 1990) ("A court recently remarked, '[t]he Uniform Commercial Code's

to the code recategorized the majority of consignments under the umbrella of Article 9.⁷⁴ Revisions also diminished the application of Article 2 in consignment transactions by removing all references to “consignment” from the language of section 2-326.⁷⁵ These revisions thus gave Article 9 a much more expansive reach over all types of consignment transactions.⁷⁶ Consignment interests became more connected to security interests with the amendment of the definition of “security interest” to encompass “*any interest of a consignor.*”⁷⁷ Additionally, an amendment to the UCC extended the provision setting out the “general scope of the article” to explicitly include consignment transactions.⁷⁸

Article 9 lists the requirements for qualification as a consignment. For instance, the aggregate value of the goods must exceed \$1,000 and, of particular concern to art consignment, the merchant must not be “generally known by its creditors to be substantially engaged in selling the goods of others” and the goods must not be “consumer goods immediately before delivery.”⁷⁹ Based on this definition, consignments to a merchant who was not generally known to be substantially consigning goods would fall outside of Article 9. Additionally, the status of the goods immediately prior to consignment might complicate the application of Article 9. Under Article 9, “consumer goods” are defined as goods “used or bought primarily for personal, family, or household purposes.”⁸⁰ Categorizing artwork under Article 9 may be uniquely difficult because a piece of artwork may be analogized to a piece of home décor or to a stock,⁸¹

provisions regarding consignments are not models of draftmanship’ When courts are forced to apply a confusing state law scheme to determine federal bankruptcy rights, confusion inevitably occurs.” (alteration in original) (quoting Ingrid Michelsen Hillinger, *The Treatment of Consignments in Bankruptcy: Two Codes and Their Fictions, at Play, in the Fields*, 6 BANKR. DEV. J. 73, 119 (1989))).

74. Singer & Warren, *supra* note 14, at 28.

75. *Id.* at 29.

76. *Id.*

77. U.C.C. § 1-201(35) (2008) (emphasis added).

78. U.C.C. § 9-109(a)(4).

79. *Id.* § 9-102(a)(20).

80. *Id.* § 9-102(a)(23).

81. See Daniel Gross, *Painting for Profit: Is Art a Good Investment?*, SLATE, June 21, 2006, <http://www.slate.com/id/2144185/> (providing as one example of the similarity of art to shares in a company, New York University Professors Michael Moses and Jiangping Mei’s creation of a Dow Jones–like indicator of fine art performance in their Mei Moses index). Gross noted that “over the last 50 years, stocks (as represented by the S&P 500) returned 10.9 percent annually, while the art index returned 10.5 percent per annum.” *Id.*

and could just as easily be characterized as a good bought primarily for personal use, as a good bought primarily as investment property. If a court deemed that the artwork was bought primarily for personal use immediately before its delivery to a gallery, Article 9 would also not apply.

If a court deems a consignment to be within the ambit of Article 9, the amended UCC grants a consignor a chance to obtain superpriority if the consignor properly complies with UCC filing requirements.⁸² UCC section 9-103(d) states that “the security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.”⁸³ The drafters broke from previous versions of the UCC, which had a specific provision regarding the priority of consignors.⁸⁴ The amended version gives consignors the same treatment under Article 9 as it does purchase-money security holders of inventory.⁸⁵ The boon of this grant of a purchase-money security interest is that, if perfected, the purchase-money security holder generally has priority over all other conflicting security holders.⁸⁶ The caveat that accompanies the grant is that the consignor must still perfect the purchase money-security interest. Filing a UCC-1 financing statement is the most practical way for an artwork consignor to perfect a security interest.

To obtain unchallenged superpriority, the UCC requires consignors to follow notification procedures that give other security holders notice of their interest in the consigned goods.⁸⁷ Purchase-money security holders must perfect their purchase-money security interest when the debtor gains possession of the inventory.⁸⁸ In addition, Article 9 requires the purchase-money security holder to ensure that the “holder of [a] conflicting security interest receives the notification within five years before the debtor receives possession of

82. U.C.C. § 9-103(d).

83. *Id.*

84. *Id.* § 9-103 cmt. 6 (“Under former Section 9-114, the priority of the consignor’s interest is similar to that of a purchase-money security interest. . . . This drafting convention obviates any need to set forth special priority rules applicable to the interest of a consignor.”).

85. *Id.* (“Rather, the priority of the consignor’s interest . . . can be determined by reference to the priority rules generally applicable to inventory, such as Sections 9-317, 9-320, 9-322, and 9-324.”).

86. *Id.* § 9-324.

87. *Id.*

88. *Id.* § 9-324(b)(1).

the inventory” if the conflicting security holder had filed on the holder’s security interest.⁸⁹

The drafters also amended section 2-326 in 2001.⁹⁰ In the amendments, the drafters deleted the consignee-friendly generally known exception from section 2-326(3),⁹¹ but retained the section’s division of sales into two categories—“sale on approval” and “sale or return” transactions.⁹² Section 2-326 makes the distinction between whether goods are “sale on approval” or “sale or return” critical, because if goods are deemed the former they are not claimable by creditors until accepted by the buyer, but if goods are deemed the latter they are claimable by creditors “while in the buyer’s possession.”⁹³

Article 9 of the revised UCC includes a generally known provision similar to the much-debated generally known exception of former UCC section 2-326(3).⁹⁴ The former section 9-114 did not have a generally known exception, so the former section 2-326(3) provides the best point of comparison. Although the two exceptions operate similarly, the exception in former section 2-326(3) gave consignors rights to their artwork, whereas after consignors win the revised Article 9 generally known exception, they must continue to fight for their artwork. Under the former section 2-326(3), the generally known exception allowed consignors to effectively snuff out the claims of competing third-party creditors to consigned goods.⁹⁵ Under the Revised Article 9, if the consignee succeeds in showing that the consignee was “generally known to be substantially selling” the consignee proves that the transaction does not fall under Article 9.⁹⁶ Proving this exception under the Revised Article 9 does not give

89. *Id.* § 9-324(b)(3).

90. Singer & Warren, *supra* note 14, at 28–29.

91. See discussion *supra* Part I.A.

92. Singer & Warren, *supra* note 14, at 28.

93. U.C.C. § 2-326.

94. *Id.* § 9-102(20).

95. U.C.C. § 2-326(3) (2000).

96. William F. Savino & David S. Widenor, *Commercial Law*, 55 SYRACUSE L. REV. 761, 843–44 (2005) (“[A] consignee’s showing that its consignee is so ‘generally known’ actually dictates under revised section 9-102(a)(20) that the consignee/merchant is not a party to a consignment (as statutorily defined).”); *But see In re Valley Media, Inc.*, 279 B.R. 105, 124 (Bankr. D. Del. 2002) (declaring the Revised Article 9 generally known exception functionally equivalent to the prerevision section 2-326(3), saying, “[w]hile the purpose of this test is different under former U.C.C. § 2-326(3) and revised U.C.C. § 9-102(a)(20), the effect of proving this proposition is the same under either provision”).

consignors a right to retrieve their artwork from the bankruptcy estate; instead, courts further analyze whether the transaction falls under section 2-326(3), and if it does not, courts apply common law principles of bailment.⁹⁷

The generally known exception continues to be particularly salient with respect to art dealerships. As discussed in Section A, consignors might argue that art dealerships, which in the nature of their business buy and sell goods on consignment, are “generally known by . . . creditors to be substantially engaged in selling the goods of others.”⁹⁸

In *In re Morgansen’s Ltd.*,⁹⁹ the court rejected the generally known exception as applied to a jewelry, furniture, and collectibles shop that acquired 70 percent of its goods through consignment.¹⁰⁰ The court also downplayed the fact that a sign outside the business advertised that it also had auctioneer services.¹⁰¹ The opinion highlighted that the consigned and nonconsigned goods had been “commingled,” and that the majority of customers browsing in the store would not be able to tell which of the goods for sale were consigned and which were owned by the store itself.¹⁰² General creditors would likely argue that Morgansen’s business is analogous to the business of art dealerships, in which some goods are consigned, some are owned by the dealership, and others are on loan from museums and private parties. Because consigned art is “commingled” with art the gallery owns, they would argue, the generally known exception should not apply. Art-law experts have noted that artist-consignors have had trouble proving the “general knowledge” of creditors in court.¹⁰³

97. See, e.g., *In re Morgansen’s Ltd.*, 302 B.R. 784, 787 (Bankr. E.D.N.Y. 2003) (“The standard approach is first to go to section 9-102(a)(20), and if the transaction does not fit under this section, then to go next to section 2-326; if the transaction does not fit under section 2-236 [sic], then the transaction falls entirely outside the Uniform Commercial Code, and the Court must then fall back on the common law of bailments and other traditional practices.”).

98. U.C.C. § 9-102(20) (2008).

99. *In re Morgansen’s Ltd.*, 302 B.R. 784 (Bankr. E.D.N.Y. 2003).

100. *Id.* at 785–88.

101. *Id.* at 788.

102. *Id.*

103. CRAWFORD & MELLON, *supra* note 24, at 58 (“[General knowledge] may be difficult and costly to prove. It leaves open to question whether there is a significant difference between ‘partially engaged’ and ‘substantially engaged,’ and this distinction could yield two very different outcomes in terms of the artist’s works.”). These same issues would likely plague a collector-consignor’s “general knowledge” claim.

Despite attempts by the UCC drafters to simplify the analysis of the consignment of goods, confusion still persists. Courts often begin their analysis of consignment transactions by examining whether the transaction fits within Article 9.¹⁰⁴ Section 2-326's application is not completely dead, however.¹⁰⁵ In analyzing consignment transactions after the 2001 revisions, many courts have followed an analytical map that draws on section 2-326.¹⁰⁶ First, courts look to see if the transaction fits within Article 9.¹⁰⁷ If the transaction fails one of the elements of section 9-102(a)(20), courts then see if section 2-326's "sale on approval" or "sale or return" provisions are applicable.¹⁰⁸ Finally, if both Article 9 and section 2-326 do not apply, courts revert to the common law of bailments to try to resolve the issue.¹⁰⁹ Providing an example of a possible course of relief from the exhausting battles for consignors under the UCC, states have responded with legislation offering unique protection for artist-consignors that insulates their work from being attached in a consignee's bankruptcy.

II. STATE LAW HAS RESPONDED TO PROTECT ARTIST-CONSIGNORS

State law has responded to protect artist-consignors.¹¹⁰ Thirty-one states have passed consignment statutes that specifically carve out

104. See *In re Morgansen's, Ltd.*, 302 B.R. at 787 ("The standard approach is first to go to section 9-102(a)(20) . . .").

105. There are arguments, however, that since 2001, section 2-326's application to non-"present sale" consignments should be dead. See *In re Haley & Steele, Inc.*, No. 051617BLS, 2005 WL 3489869, at *4 (Mass. Dist. Ct. Nov. 14, 2005) ("[I]t is unlikely that the drafters wished to leave the consumer consignor worse off than a commercial consignor, yet that would be the outcome if consumer consignment (now excluded from Article 9) are governed by 2-326." (quoting 4 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 38 cmt. 4 (5th ed. 2000))).

106. See, e.g., *In re Morgansen's, Ltd.*, 302 B.R. at 787 ("The standard approach is first to go to section 9-102(a)(20), and if the transaction does not fit under this section, then to go next to section 2-326; if the transaction does not fit under section 2-236 [*sic*], then the transaction falls entirely outside the Uniform Commercial Code, and the Court must then fall back on the common law of bailments and other traditional practices.").

107. See *id.* (noting that the typical first step of the consignment law analysis is to look to section 9-102(a)).

108. See *id.* (stating that after looking to section 9-102 and determining that the "transaction does not fit," courts turn to section 2-326).

109. *Id.*

110. See, e.g., N.Y. ARTS & CULT. AFF. LAW § 12.01 (McKinney Supp. 2008) (providing protections for and delineation within the artist-consignor relationship).

rights for artists.¹¹¹ Many of these statutes aim to offer artists “safe harbor” from the claims of creditors.¹¹² These statutes are not perfect, however. One potential weakness of some of these state statutes is their failure to unequivocally establish their preemption of the UCC.¹¹³ UCC section 1-104 states that no section “shall be deemed to be impliedly repealed by subsequent legislation.”¹¹⁴ Many experts fear that despite the enactment of art consignment statutes, the absence of express language repealing UCC section 2-326 and Article 9 might leave the UCC, not the state statute, controlling.¹¹⁵ The artist consignment statutes in New York and California, two states traditionally known for their devotion to the arts, offer examples of language and mechanisms used to protect artists’ rights to their consigned artwork in bankruptcy that might similarly be used to protect collector-consignors and their artwork.¹¹⁶

111. ALASKA STAT. § 45.65.200 (2008); ARIZ. REV. STAT. ANN. § 44-1772 (2003); ARK. CODE ANN. § 4-73-207 (2001); CAL. CIV. CODE § 1738.6 (West 2008); COLO. REV. STAT. § 6-15-102 (2008); CONN. GEN. STAT. ANN. § 42-116l (West 2007); FLA. STAT. ANN. § 686.503 (West 2003); GA. CODE ANN. §§ 10-1-520 to -529 (2000); IDAHO CODE ANN. § 28-11-102 (2001); 815 ILL. COMP. STAT. ANN. 320/2-2 (West 2008); IOWA CODE ANN. §§ 556D.2-.5 (West 2001); KY. REV. STAT. ANN. §§ 365.855-.860 (West 2006); LA. REV. STAT. ANN. § 51:2151 (2003); MD. CODE ANN., COM. LAW §§ 11-8A-01 to -04 (LexisNexis 2005); MASS. ANN. LAWS ch. 104a, §§ 1-6 (LexisNexis 1995); MICH. COMP. LAWS ANN. §§ 442.311-.315 (West 2002); MINN. STAT. ANN. §§ 324.01-.10 (West 2004); MO. ANN. STAT. §§ 407.900-.910 (West 2002); MONT. CODE ANN. §§ 22-2-501 to -503 (2008); N.H. REV. STAT. ANN. §§ 352:3-.12 (1995); N.J. STAT. ANN. §§ 12A:2-329 to -336 (West 2004); N.M. STAT. ANN. §§ 56-11-1 to -3 (2008); N.Y. ARTS & CULT. AFF. LAW § 12.01; N.C. GEN. STAT. ANN. §§ 25C-1 to -4, 25C-12 (West 2003); OHIO REV. CODE ANN. §§ 1339.71-.78 (West 2004); OR. REV. STAT. §§ 359.200-.255 (2007); 73 PA. CONS. STAT. ANN. §§ 2121-30 (West 2008); TENN. CODE ANN. §§ 47-25-1001 to -1006 (2001); TEX. OCC. CODE ANN. §§ 2101.001-.003 (Vernon 2004); WASH. REV. CODE §§ 18.110.010-.030, 18.110.900 (2005); WIS. STAT. ANN. §§ 129.01-.08 (West 2001).

112. RALPH E. LERNER & JUDITH BRESLER, *ART LAW: THE GUIDE FOR COLLECTORS, INVESTORS, DEALERS, AND ARTISTS* 41 (Practicing Law Inst. ed., 3d ed. 1998).

113. CRAWFORD & MELLON, *supra* note 24, at 65.

114. U.C.C. § 1-104 (2008).

115. *See* CRAWFORD & MELLON, *supra* note 24, at 65 (noting that the absence of specific repeals of the UCC may fail UCC preemption, “seriously calling into question the application of the statute”); *see also* Marcone, *supra* note 47, at 591-92 (“The case law supports the proposition that the Code will trump subsequent legislation unless that subsequent legislation expressly repeals the Code, if not the specific Code sections. If the legislation does not contain such a repealer, the courts will attempt to harmonize the subsequent legislation with the UCC; and should the conflict between the two be irreconcilable, courts will find that the Code governs.” (footnote omitted)).

116. CAL. CIV. CODE § 1738.6 (West 2008); N.Y. ARTS & CULT. AFF. LAW § 12.01.

A. *State Consignment Statutes: New York and California*

New York was at the forefront in passing legislation to protect artists in consignment transactions. According to McKinney's Arts and Cultural Affairs Law section 12.01, whenever an artist delivers artwork to a merchant for the purpose of sale on commission, a consignor-consignee relationship forms.¹¹⁷ When this occurs, the New York statute places obligations on the art merchant: "(i) such consignee shall thereafter be deemed to be the agent of such consignor with respect to the said work" and "(ii) such work is trust property in the hands of the consignee for the benefit of the consignor."¹¹⁸ The property continues to be trust property "notwithstanding its purchase by the consignee for his own account until the price is paid in full to the consignor," and, if the artwork is sold to a third-party,

the resale proceeds are trust funds in the hands of the consignee for the benefit of the consignor to the extent necessary to pay any balance still due to the consignor and such trusteeship shall continue until the fiduciary obligation of the consignee with respect to such transaction is discharged in full.¹¹⁹

Most importantly for artist-consignors facing the bankruptcy of their art dealer, the New York statute establishes the unqualified superiority of the artist's trust property, saying, "no such trust property or trust funds shall be subject or subordinate to any claims, liens or security interest of any kind or nature whatsoever."¹²⁰

The statute's creation of a trust, with express language that the trust property and proceeds should not be subordinate to any other claims, provides a clear statement of the artist's priority in bankruptcy.¹²¹ Consignors not protected by the Arts and Cultural Affairs Law would likely have to battle other creditors for priority. Unprotected consignors would have to point to evidence that they

117. N.Y. ARTS & CULT. AFF. LAW § 12.01(a). The statute also extends to transactions "[w]hensoever an artist or craftsman, his heirs or personal representatives" deliver the artwork to an art merchant. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *See id.* (noting the prohibition on subordinating the trust property).

complied with Article 9 filing and notice requirements.¹²² In the event that the creditor could establish that Article 9 did not apply, the consignor might also be forced to confront section 2-326.¹²³

California also has been progressive in advancing artist rights. As in New York, California has declared the existence of a consignor-consignee relationship whenever an artist delivers artwork to an art merchant for sale and the artist does not receive complete payment at delivery.¹²⁴ The statute notes that: “(a) The art dealer, after delivery of the work of fine art, shall constitute an agent of the artist for the purpose of sale or exhibition of the consigned work of fine art within the State of California;” and “(b) The work of fine art shall constitute property held in trust by the consignee for the benefit of the consignor, and shall not be subject to claim by a creditor of the consignee.”¹²⁵ Like New York’s statute, California’s statute also provides that “proceeds from the sale of the work of fine art shall constitute funds held in trust by the consignee for the benefit of the consignor.”¹²⁶

California Civil Code section 1738.6 further notes that the trust “shall not be subject to claim by a creditor of the consignee.”¹²⁷ This language disallowing claims to the trust artwork by creditors of the consignee presumptively prevents the bankruptcy trustee from seizing the artwork or its proceeds as property of the bankruptcy estate.¹²⁸ In addition to its artist consignment statute, California has also enacted legislation that gives artists a percentage of sale proceeds whenever artwork is resold in California and the seller is a California resident.¹²⁹

122. See U.C.C. § 9-310 (2008) (requiring the filing of a financing statement for perfection of a security interest and listing relevant exceptions, which do not include a purchase-money security interest in inventory as an exception).

123. See *In re Morgansen’s Ltd.*, 302 B.R. 784, 788 (Bankr. E.D.N.Y. 2003) (“The analysis then proceeds to section 2-326 . . .”).

124. CAL. CIV. CODE § 1738.5 (West 2008).

125. *Id.* § 1738.6(a)–(b).

126. *Id.* § 1738.6(d).

127. *Id.* § 1738.6.

128. See CRAWFORD & MELLON, *supra* note 24, at 62 (“It is [the trust-creation] provision which protects the artist’s works from the claims of the gallery’s creditors if the gallery goes bankrupt. Under the UCC, which governs in the absence of this type of statute, the works would not be adequately protected from these claims unless the artist had filed appropriately under Article 9.”).

129. See CAL. CIV. CODE § 986(a) (“Whenever a work of fine art is sold and the seller resides in California or the sale takes place in California, the seller or the seller’s agent shall pay to the artist of such work of fine art or to such artist’s agent 5 percent of the amount of such sale.”).

The status of the artist's percentage of sale proceeds in bankruptcy is another unsettled issue. The language and trust devices used to protect artist-consignors provide models of how such protective devices might be extended to collector-consignors. If state statutes could create trusts for collector-consignors as they do for artist-consignors, collector-consignors could rely on the statute to retain their consigned artwork and circumvent conflicting creditors' claims and bankruptcy proceedings.

III. THE LACK OF PROTECTION FOR COLLECTOR-CONSIGNORS

Though the state statutes protecting artists in consignment transactions may be imperfect, they offer far better protection than that afforded to collector-consignors. Collector-consignors cannot point to a state statute that grants them superior priority to artwork or its proceeds. Art consignment statutes are typically limited to artists, their representatives, or their heirs.¹³⁰ As in the Salander and Berry-Hill proceedings, collectors are often left in the lurch.

Case law has not yet fully fleshed out how a collector's claim would proceed in bankruptcy. Reasoning by analogy, combined with the few decisions and memoranda available, however, provides insight into how courts are likely to rule.¹³¹ In this Part, by analyzing the status of a hypothetical collector-consignor Susan and her rights in bankruptcy, the problems of the status of collector-consignors in bankruptcy emerge.

Consider collector Susan who owns a Picasso but wants to take her collection in a new direction. She seeks out a reputable art dealership to help her obtain the best value when she sells the Picasso. Susan is unfamiliar with the financing structure of the

130. See, e.g., N.Y. ARTS & CULT. AFF. LAW § 12.01 (identifying the parties entitled to rights under the statute as "artist[s] or craftspe[ople], [their] heirs or personal representative[s]").

131. See *Cantor v. Anderson*, 639 F. Supp. 364, 368–69 (S.D.N.Y. 1986) (denying a creditor-consignor's claim to a Renoir that another consignor had consigned to a dealer and rejecting the creditor-consignor's attempt to rely on section 2-326); see also *Carroll v. Rafael Galleries, Inc. (In re Altman)*, 254 B.R. 509, 516 (D. Conn. 2000) (vacating the bankruptcy court's determination that "fraudulently conveyed/invalidly consigned" paintings were part of a bankruptcy estate because the owner claiming interest in the paintings did not have "actual notice and a meaningful opportunity to be heard" when the paintings were deemed part of the bankruptcy estate); *In re Haley & Steele, Inc.*, No. 051617BLS, 2005 WL 3489869, at *4 (Mass. Dist. Ct. Nov. 14, 2005) (analyzing consigned paintings according to Article 9, section 2-326, and bailment law and categorizing one class of consignors as "consumer consignors," which placed their consigned goods outside of the scope of Article 9).

dealership, but the dealership has third-party creditors who have loaned it money to acquire paintings for sale at the dealership. She decides to enter into a consignment relationship with this dealership. She insists that she and the dealership detail their expectations about their consignment relationship in a contract. She delivers the painting to the art dealership and the dealership hangs the painting in its gallery. Unbeknownst to Susan, the gallery has financed its operations through loans from creditors who have filed UCC financing statements covering their security interest in the gallery's inventory. Once she delivers the painting to the gallery, she considers her work done and waits for the dealership to successfully sell her painting. Three months later, in the midst of serious financial trouble, the dealership files for bankruptcy. The trustee in bankruptcy seizes Susan's painting. Susan wants to retrieve her Picasso immediately and find another dealer to sell it.

In analyzing Susan's claim to the Picasso, courts would first look at whether the consignment of the Picasso falls under the definition of consignment set forth in section 9-102(a)(20).¹³² Article 9's application to Susan's consignment may be challenged on the grounds that the dealership to which she consigned the painting was "generally known by its creditors" to be substantially engaged in consigning artwork and the Picasso was "consumer goods immediately before delivery."¹³³

Under the definition of consignment in Article 9, if a consignee was generally known to be substantially engaged in consigning, a consignment to this consignee would fall outside of Article 9.¹³⁴ In proving whether a consignment transaction meets the definition of section 9-102(a)(20), courts have placed the burden of proof on the party seeking the protection of the section.¹³⁵ Some case law analyzing the generally known exception under former section 2-326 supports a claim that the dealership was in fact generally known to be substantially engaged in the business of consigning art.¹³⁶ Contrary

132. See *In re Morgansen's Ltd.*, 302 B.R. 784, 787 (Bankr. E.D.N.Y. 2003) ("[T]he standard approach is first to go to section 9-102(a)(20) . . .").

133. U.C.C. § 9-102(a)(20) (2008).

134. *Id.*

135. *In re Morgansen's*, 302 B.R. at 787.

136. See, e.g., *Gen. Elec. Credit Corp. v. Strickland Div. of Rebel Lumber Co.*, 437 So. 2d 1240, 1245 (Ala. 1983) (upholding the trial court's decision that a consignor had met the "generally known" exception when the consignee advertised via the radio and a flashing sign that the consignee "sold goods for others").

case law, however, makes this claim difficult.¹³⁷ Recall the *In re Morgansen's* case, in which the court rejected the generally known claim of the consignor when consigned goods were commingled with nonconsigned goods.¹³⁸ Third-party creditors could counter Susan by arguing that because of the mixed nature of the art in the gallery, it was unclear which pieces were owned, which were on loan, and which were on consignment.

A court might deem the Picasso “consumer goods” immediately prior to its delivery to the dealership,¹³⁹ thereby excluding the painting from Article 9’s definition of consignment goods. Article 9 defines “consumer goods” as “goods used or bought for use primarily for personal, family, or household purposes.”¹⁴⁰ There would likely be a battle over whether the artwork was primarily for Susan’s personal aesthetic fulfillment while also serving as a financial investment, or on the other hand, was primarily a financial investment for Susan’s portfolio but with ancillary aesthetic benefits. If the Picasso was deemed purchased by Susan primarily for her personal purposes, the painting would constitute consumer goods, and the consignment would fall outside of Article 9. Proving that the painting was “consumer goods” might aid Susan’s claim to the painting because the comments to section 9-102(a) note that the section excluded goods valued at less than \$1,000 and “consumer goods” from the ambit of Article 9 because in these cases “filing would be inappropriate or of insufficient benefit to justify the costs.”¹⁴¹ Instead of Article 9, applicable bailment law regulates these transactions,¹⁴² and Susan would have strong arguments as a bailor that she is entitled to the Picasso.

137. See, e.g., *In re Morgansen's*, 302 B.R. at 788 (rejecting consignor’s claims that a consignee was “generally known” when the consignee sold its own goods “commingled” with goods it was selling on consignment); see also *In re Wedlo Holdings*, 248 B.R. 336, 342 (Bankr. N.D. Ill. 2000) (holding that a business that acquired 15 to 20 percent of its inventory via consignment was not “substantially engaged in selling the goods of others” and thus the 2-326 exception did not apply).

138. *In re Morgansen's*, 302 B.R. at 788.

139. U.C.C. § 9-102(a)(20)(C); see also *In re Haley & Steele, Inc.*, No. 051617BLS, 2005 WL 3489869, at *3 (Mass. Super. Ct. Nov. 14, 2005) (“This Court concludes, and rules . . . persons whose goods consisted of artwork that was used or bought for use primarily for personal, family, or household purposes immediately before delivery to Haley & Steele, then their artwork falls outside of the ‘consignment’ defined in sec. 9-102(20).”).

140. U.C.C. § 9-102(a)(23).

141. *Id.* § 9-102(a)(20) cmt. 14.

142. Singer & Warren, *supra* note 14, at 30.

If the consignment of the Picasso survived these definitional challenges and the court deemed the consignment transaction to meet section 9-102(a)(20)'s definition of consignment, Susan would have a purchase-money security interest in the Picasso painting pursuant to UCC section 9-103(d).¹⁴³ If consignors take steps to perfect this security interest, they have superpriority over all other claimants. If consignors fail to take steps to perfect their security interest, they stand as unsecured creditors.¹⁴⁴ Susan has not perfected her purchase-money security. Because she has not filed a UCC-1 financing statement, she would fail the Article 9 filing requirements, and thus her claim remains an unperfected security interest in the painting. Susan stands as a creditor with an unperfected interest. All perfected secured creditors have priority over Susan.

Additionally, Susan has not complied with the notification requirements for holders of purchase-money security interests in inventory. Under UCC section 9-324, if the "holder of a conflicting security interest" had filed a financing statement that encompasses the "same types of inventory" as the purchase-money security interest, the purchase-money security interest holder must comply with measures to notify the conflicting security interest holder of her interests in the debtor's property.¹⁴⁵ Section 9-324 requires that purchase-money security holders send authenticated notification to conflicting security holders, that the conflicting security holders receive the notice "within five years before the debtor receives possession of the inventory," and that the notification specifies that the sender "has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory."¹⁴⁶ For Susan's purchase-money security interest to have priority, conflicting security holders who had previously filed on their interests in the dealer's inventory must have received Susan's notification within the five-year time frame before the art dealership obtained possession of the Picasso.¹⁴⁷

If a court determined that the consignment did not fall under section 9-102(a)(20), it may consider whether the consignment falls

143. U.C.C. § 9-103(d).

144. Owens & Hoke, *supra* note 16, at 24.

145. U.C.C. § 9-324.

146. *Id.* § 9-324(b).

147. *See id.* (requiring the receipt of notice by other security interest holders, who had filed on their interests, within five years before the purchase-money security interest holder takes possession of the security object).

under section 2-326.¹⁴⁸ But section 2-326 does not provide Susan much legal footing in her quest to retrieve her painting. Third-party creditors would likely try to claim that Susan's consignment should be deemed a "sale or return" transaction under section 2-326 because a "sale or return" transaction is defined as one in which "goods are delivered primarily for resale," and her painting was consigned for the sole purpose of being resold.¹⁴⁹ Section 2-326 explicitly exposes "goods held on sale or return" to creditors' claims while in the buyer's possession,¹⁵⁰ and though the language may seem a bit strained, some courts have viewed a consignee as a "buyer for resale."¹⁵¹ After the revision to the UCC in 2001, there is no longer an escape clause for goods held by a merchant "generally known to be substantially engaged in selling consigned goods."¹⁵²

Susan's best argument would be that by eradicating all references to consignment in section 2-326 when amending the UCC, the drafters made a concerted effort to disassociate section 2-326 from consignments.¹⁵³ The court in *In re Haley & Steele*¹⁵⁴ noted that the comments to section 2-326 highlight that its "sales provisions" only regulate "present sales" and stated that Article 2 requires a transfer of title to the buyer for a transaction to constitute a sale under Article 2.¹⁵⁵ Susan could argue that section 2-326 does not apply to her painting because although she delivered the painting to the dealership, she did not transfer its title to the dealer, therefore, the consignment is arguably not a sale under Article 2.

148. See, e.g., *In re Morgansen's Ltd.*, 302 B.R. 784, 787 (Bankr. E.D.N.Y. 2003) (describing the "standard approach" of beginning by attempting to analyze a consignment transaction under 9-102(2)(a)(20), and looking to section 2-326 if Article 9 did not provide the appropriate framework for the transaction).

149. U.C.C. § 2-326(1)(b).

150. *Id.* at § 2-326(2).

151. See, e.g., *In re Morgansen's*, 302 B.R. at 789 ("If a person takes goods to one who is considered a consignee (a 'buyer' for resale) and that buyer files for bankruptcy relief, the buyer/debtor's trustee will take the goods as property of the debtor's estate.").

152. Compare U.C.C. § 2-326 (omitting all of the former section 2-326's third paragraph containing the relevant exception), with U.C.C. § 2-326(3)(b) (2000) (providing that section 2-326 (that is, the former section 2-326) is not applicable for persons in businesses "generally known by his creditors to be substantially engaged in selling goods of others").

153. See Singer & Warren, *supra* note 14, at 29 ("[A]ll references to consignments were deleted from Section 2-326, leaving this provision to govern only 'sale-or-return' and 'sale-on-approval' transactions.").

154. *In re Haley & Steele, Inc.*, No. 051617BLS, 2005 WL 3489869 (Mass. Dist. Ct. Nov. 14, 2005).

155. *Id.* at *4.

If a court found that neither Article 9 nor section 2-326 governed the Picasso's consignment, it might revert to the common law of bailment.¹⁵⁶ The law of bailment would likely aid Susan's claim to rights in her painting by giving her a right to have her painting redelivered to her. A bailment relationship arises when the bailor agrees to deliver property into the possession of the bailee, under terms that the bailee accepts, with an understanding that the property will be "redelivered to the person who delivered it, or otherwise dealt with according to his directions, or kept until he reclaims it, as the case may be."¹⁵⁷ Under the common law of bailment, the bailee has a "strict duty to return the bailed goods" when the term of bailment ends.¹⁵⁸

Bankruptcy's treatment of bailment is distinct from its treatment of consignment.¹⁵⁹ Though the bankruptcy trustee may stay the bailor from immediately retrieving bailed property once bankruptcy proceedings have begun, the trustee analyzes the rights of the estate in artwork pursuant to the bailment agreement.¹⁶⁰ The estate may be able to claim any rights to funds due to it under the bailment agreement, but a court would not consider the painting to be the property of the estate.¹⁶¹ The court in *In re Guild*¹⁶² addressed the issue of the status of a bailed painting in bankruptcy. The court alluded to the dissimilar treatment a painting receives as a bailed good rather than a secured good in bankruptcy: "[t]he Summertime painting itself, however, was not property of the estate, even under the expansive

156. See, e.g., *In re Morgansen's*, 302 B.R. at 787 ("[I]f the transaction does not fit under section 2-236 [*sic*], then the transaction falls entirely outside the Uniform Commercial Code, and the Court must then fall back on the common law of bailments and other traditional practices.").

157. 19 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 53:1 (4th ed. 2001) (quoting *State v. Warwick*, 108 A.2d 85, 89 (Del. Super. Ct. 1954)).

158. *Walton Commercial Enters. v. Ass'ns, Conventions, Tradeshow, Inc.*, 593 N.E.2d 64, 67 (Ohio Ct. App. 1990).

159. See, e.g., *Torkelsen v. Maggio (In re Guild & Gallery Plus, Inc.)*, 72 F.3d 1171, 1179–80 (3d Cir. 1996) (noting that the bailee's rights under the bailment agreement would qualify as "property of the estate"; however, the bailed painting itself would not become part of the bankruptcy estate).

160. See *id.* (noting that in bankruptcy proceedings involving bailed property, "if property was in the debtor's hands as bailee . . . the trustee held it as such, and the bailor . . . could recover the property or its proceeds. . . the estate will include the debtor's rights under the bailment . . . contract" (third omission added) (emphasis omitted) (quoting 4 COLLIER ON BANKRUPTCY ¶ 541.08[2], at 42–43 (15th ed. 1995))).

161. *Id.* at 1180.

162. *Torkelsen v. Maggio (In re Guild & Gallery Plus, Inc.)*, 72 F.3d 1171 (3d Cir. 1996).

definition set forth in section 541 of the Bankruptcy Code. *The estate had no security interest in the painting.* Upon satisfaction of bailment agreement, the painting . . . had to be returned.”¹⁶³ Susan would have a strong claim that she was a bailor of the Picasso, that the term of bailment had ended, and that the painting should be returned to her.

Though the system still gives Susan opportunities to reclaim her work from the clutches of bankruptcy, her rights to her painting are not guaranteed. She must fight her claim in an area of the law where “total confusion can reign.”¹⁶⁴ Susan must hope for the best-case scenario in which a judge can divine the fine distinctions of a consignor’s rights in bankruptcy. She will have to devote money and time to pursuing her rights to the painting and hope that a judge does not succumb to the confusing maze of consignment in bankruptcy and rule that the painting is property of the bankruptcy estate.

IV. RECONSIDERING THE TREATMENT OF COLLECTOR- CONSIGNORS IN BANKRUPTCY

To best promote the arts, state art consignment statutes should be amended to protect collector-consignors. In the wake of the Salander and Berry-Hill bankruptcies, the specter of bankruptcy looms over art galleries.¹⁶⁵ With the risk of losing their consigned work in bankruptcy proceedings, collectors may become more skeptical of selling their artwork through galleries. Major collector James McGlothlin’s comments about having his artwork mired in the Berry-Hill bankruptcy proceedings are telling: “It was frustrating to be involved in something where you couldn’t get title to your property. This has changed the way we deal with all the galleries. It has been a bad thing for everyone.”¹⁶⁶

The treatment of consignment in bankruptcy has often been described as mystifying.¹⁶⁷ Even following the 2001 UCC revision, collectors may be confused about what they must do to perfect a

163. *Id.* at 1180 (emphasis added).

164. Hillinger, *supra* note 73, at 74.

165. See Mario Naves, *The Enron of the Art World?*, N.Y. OBSERVER, Oct. 16, 2007, <http://www.observer.com/2007/enron-art-world> (“Anyone believing that Salander-O’Reilly is the only gallery built upon a house of cards believes wrong.”).

166. Dizard, *supra* note 4 (quoting collector James McGlothlin).

167. See Hillinger, *supra* note 73, at 73 (noting that the treatment of consignment in bankruptcy “can baffle persons not fully acquainted with the mysteries of both the Uniform Commercial Code . . . and the Bankruptcy Reform Act of 1978 . . . [and i]t can confuse even those who are.” (emphasis omitted)).

purchase-money security interest in their consigned artwork. These issues, when combined with the art world's lax treatment of written contracts and paperwork attached to artwork, suggest revising the treatment of collector-consignors in bankruptcy. First, creating the presumption that art dealerships are generally known to be selling the goods of others and making proof of the section 9-102(a)(20) generally known exception sufficient to exempt consigned artwork from bankruptcy would help shape a bankruptcy policy that recognizes that the art trade is founded on consignment. Second, extending statutory protection already available to artist-collectors to consignor-collectors would help return the consignment in bankruptcy policy to the purpose originally envisioned by the UCC's drafters.

A. *Creating a Generally Known Presumption for Art Consignor-Collectors*

Section 9-102(a)(20)(A)(iii) subtly changes the protections given under its precursor, former section 2-326(3).¹⁶⁸ The comments to the revised section 2-326 note that “[c]ertain true consignments transactions were dealt with in former Sections 2-326(3) and 9-114. These provisions have been deleted and have been replaced by new provisions of Article 9.”¹⁶⁹ The language of section 9-102(a)(20) closely tracks the language of former section 2-326(3), requiring that a consignee must be “not generally known . . . to be substantially engaged in selling the goods of others.”¹⁷⁰ But under the older provision, if the consignor met the generally known exception, the consigned property would be excepted from bankruptcy proceedings. On the other hand, meeting the generally known exception under revised Article 9 “actually dictates under [the provision] that the consignee/merchant is not a party to a consignment (as statutorily defined),”¹⁷¹ leaving consigned art vulnerable to the claims of third-party creditors.

168. See Savino & Widenor, *supra* note 96, at 844 (“The second alternative to filing, establishing to the trier of fact, under former section 2-326(3)(b), that the bailee was routinely a consignee [generally known], was frequently a factual battleground and continues to be under the terms of the revised section 9-102(a)(20)(A)(iii).”).

169. U.C.C. § 2-326 cmt. 4 (2008).

170. Singer & Warren, *supra* note 14, at 30 (noting that the generally known exception is among the language “essentially transported verbatim from former Section 2-326”).

171. Savino & Widenor, *supra* note 96, at 844.

A California court noted the common underlying intent of the former generally known exception in section 2-326 and its incarnation in section 9-102(a)(20), stating, “[t]he purpose of former UCC § 2-326(3) and now revised UCC §§ 9-102(a)(20) & 9-319(a) is to protect general creditors of the consignee from claims of consignors that have undisclosed consignment arrangements with the consignee that create secret liens on the inventory.”¹⁷² The policy reasons for allowing third-party creditors to attach consigned property when the consignee files for bankruptcy are not convincing in an art gallery setting. The major policy rationale for allowing third-party creditors to claim consigned goods is that unknowing creditors will think the debtor-consignee has “ostensible ownership” of consigned goods.¹⁷³ In the art gallery context, this justification is less compelling than in industries in which the possibility of consignment may never occur to creditors.

Adopting an approach in which meeting the section 9-102(a)(20) generally known exception would give consignors the right to exempt their consigned goods from bankruptcy would help ensure that the exception continues to protect unknowing creditors. Otherwise creditors who are fully aware of a consignee’s consignment practices might be armed with a tool to undermine the consignors’ claims to their goods. Without such an approach, the effect of proving the generally known exception does not greatly aid the consignor. Even after showing that an art dealership was generally known to be selling consigned goods, consignors are still forced to wrestle with section 2-326 to save their consigned artwork from bankruptcy.¹⁷⁴ In light of the similar goals and language of the former section 2-326(3) and section 9-102(a)(20) generally known provisions, proving the exception of section 9-102(a)(20) should have analogous effect to that of former

172. *In re Valley Media, Inc.*, 279 B.R. 105, 125 (Bankr. D. Del. 2002).

173. See Hillinger, *supra* note 73, at 79 (highlighting the implication that “the drafters were concerned with the problem of the ‘buyer’s’ ostensible ownership of the goods,” and that “[c]reditors of a ‘buyer’ in a ‘sale or return’ transaction could easily conclude the ‘buyer,’ in possession of the goods, owned the goods”); see also *In re Morgansen’s Ltd.*, No. 04-CV-0268(ADS), 2005 WL 2370856, at *6 (E.D.N.Y. Sept. 27, 2005) (“Regardless of the legal theory of the consignment, in practical operation it looks like a sales transaction in which the unpaid seller retains a secret lien in his goods. *From a creditor’s point of view, the consigned goods appear to be part of the regular inventory of the consignee which, therefore, ought to be subject to their claims.*” (quoting *In re Truck Accessories Distrib., Inc.*, 238 B.R. 444, 448 (Bankr. E.D. Ark. 1999))).

174. See Savino & Widenor, *supra* note 96, at 846 (noting that even when a consignment transaction falls outside of Article 9’s definition of consignment, “the consignor can still be subordinated to its consignee’s creditors if the transaction is a ‘sale or return’ under section 2-326(1)(b)”).

section 2-326(3). This would best protect unknowing creditors without burdening consignors in industries in which consignment is a given.

The drafters of the UCC originally created the generally known exception to protect “creditors of the buyer [who] may reasonably be deemed to have been *misled by the secret reservation* [of consigned goods].”¹⁷⁵ Art gallery creditors who know or should know of the art gallery’s trade in consigned goods, however, may seek the aid of the generally known exception despite the fact that the reservations on these goods are likely far from secret.¹⁷⁶ In light of the widespread practice of consignment in the art world, the presumption should be that a gallery is generally known by its creditors to be substantially selling in consigned works. Creating the presumption that art dealerships are generally known to deal in consigned goods would help return to the policy goals originally sought by the drafters. The creditors should bear the costs of proving that the gallery was not generally known to be substantially selling in consigned goods. Because consignment is a common practice in the art world,¹⁷⁷ creditors should assume that some of the gallery’s business involves sales of consigned work. With the possibility of consignment in mind, creditors should explore the gallery’s sale practices before they extend credit to a gallery. If a large percentage of the gallery’s inventory is consigned artwork, the creditor should be aware that the consigned work is not part of the gallery’s estate. Though rates of consignment may vary depending on the dealer’s practices and market demands, the fact that a gallery is selling consigned work should not come as a sudden shock to creditors when a gallery declares bankruptcy.

In the art world, an industry partially based on consignment, the baseline assumption should be that a gallery is substantially selling consigned work. If third-party creditors wish to challenge this baseline assumption, they should bear the burden of proving that the gallery operated in a way that made consigned paintings tantamount to hidden liens. If the art gallery obscured its consignment practices

175. U.C.C. § 2-326 cmt. 2 (2000) (emphasis added).

176. Courts have been receptive to modifying the burden of the generally known exception of section 2-326 depending on the circumstances of consignment. *See* Marcone, *supra* note 47, at 605 (“*Zwagerman* is just one example of the courts’ willingness to increase the burden on creditors above what is prescribed in the statute, and demonstrates that courts are willing to allow at least certain consignors to prevail by means of this exception.”).

177. CRAWFORD & MELLON, *supra* note 24, at 3.

and attempted to conceal the consignment stock in its inventory, third-party creditors may make compelling arguments that the consignment agreements essentially amounted to “hidden liens” over gallery property. These creditors, however, would bear the burden of showing that circumstances caused them to be deceived by secret consignments.

Creating a presumption that art dealerships are generally known and allowing consignors who prove the exception to exclude the consigned artwork from the bankruptcy estate will likely make creditors more conscientious about determining the consignment practices of galleries before they extend credit. Though some may caution that employing this presumption will potentially limit the credit available to galleries, the allure of the industry and the potential security of paintings that the gallery owns would likely still be a draw. Creating the presumption that art dealerships are generally known and making proof of the exception sufficient to exempt consigned artwork from bankruptcy may make creditors more proactive in investigating the financial wellbeing of a gallery on the front end.¹⁷⁸

B. Extend Statutory Protection to Collector-Consignors

State statutes protecting artist-consignors provide a model for legislation that might protect consignor-collectors’ rights. The New York and California statutes provide examples of statutory language that would grant consignors priority rights in their consigned art and proceeds.¹⁷⁹ Language that clearly established that a consignment relationship creates a trust between the collector and the consignor and that “no such trust property or trust funds shall be subject or subordinate to any claims, liens or security interest of any kind or nature whatsoever” would be helpful.¹⁸⁰ Such language would provide

178. See, e.g., James Panero, *An Old Master in Ruins*, N.Y. MAG., Mar. 24, 2008, <http://nymag.com/news/features/45324> (describing how Salander-O’Reilly obtained new financing from creditors after an initial bout of financial problems). Perhaps if creditors bore the burden of proving that the gallery was not “generally known,” these creditors might have inquired more into Salander’s sales practices and financial accountings.

179. See CAL. CIV. CODE § 1738.6 (West 1998) (featuring provisions that create trusts for the consigned work of artists, insulating the work from claiming creditors in bankruptcy); N.Y. ARTS & CULT. AFF. LAW § 12.01 (McKinney Supp. 2008) (containing similar provisions).

180. N.Y. ARTS & CULT. AFF. LAW § 12.01.

clarity in an area marked by confusion.¹⁸¹ If collectors could point to a collector-consignment statute, they might be able keep their artwork and proceeds outside of the bankruptcy milieu. Such language would also give a collector-consignor an automatic claim to consigned artwork and its proceeds. Collector-consignors would no longer be required to show that they are secured creditors who have met UCC filing requirements.

Opponents of extending statutory protection to collector-consignors might argue that such a statute is unnecessary. They might contend that a responsible collector could gain adequate protection by simply filing a UCC-1 financing statement.¹⁸² Collectors likely appear much less sympathetic and defenseless to the rules of UCC filing than starving artists. Opponents may further argue that collectors often have access to resources and counsel to help them make UCC filings. These arguments, though pragmatic, ignore the realities of the art business.

The art market operates under fluid principles of accounting and recording. Gentleman's agreements and handshake deals are the rules of the art trade.¹⁸³ Some dealers view being asked to sign UCC financing statements as "almost an insult."¹⁸⁴ Art dealers view the paperwork attached to UCC-1 filings as bothersome.¹⁸⁵ Requiring UCC-1 forms in a world in which written contracts are often not drafted creates a rule that is out of touch with the realities of the art market. In 1992, an Article 9 study group composed of a number of commercial law experts argued in favor of eliminating the filing

181. See Hillinger, *supra* note 73, at 74 ("When the consignment transaction enters the magical kingdom of bankruptcy, total confusion can reign.").

182. See Dizard, *supra* note 4 (quoting a Berry-Hill creditor on the lack of due diligence in UCC filings and arguing that "[a]n eight-year-old can turn on an online database which gives liens on owners as well as on individual objects").

183. See Haden-Guest, *supra* note 32 (discussing the "culture of handshakes and secrecy" in the art world).

184. Suzanna Andrews, *The Art of the Steal*, CONDÉ NAST PORTFOLIO, Apr. 2008, at 124, 144, available at <http://www.portfolio.com/culture-lifestyle/culture-inc/arts/2008/03/17/Art-Dealer-Larry-Salander-Trials> (quoting art dealer Richard Feigen); see also Haden-Guest, *supra* note 32 ("Anyone tries to take precautions in this business, it's offensive to someone. Someone not too long ago wanted us to show a painting to a client of ours. And they wanted us to sign a UCC filing. *As if we were a debtor!*" (quoting Richard Feigen)).

185. See CRAWFORD & MELLON, *supra* note 24, at 29 (noting that in artist-dealer transactions, dealers are usually reluctant to spend the time "go[ing] through the paperwork necessary to place the lien on the artwork and later remove it at the time of sale"). Crawford and Mellon note, however, that there is an exception to this general reluctance toward UCC paperwork when an art piece is highly valued. *Id.*

requirement for “transactions for which requiring the filing of a financing statement (on pain of subordination) would be inappropriate (e.g., the delivery for sale of consumer goods by a natural person or art by artists).”¹⁸⁶ They noted that it was unreasonable to require “most natural persons” who deliver their work to a consignee to precisely follow UCC filing requirements.¹⁸⁷ The study group also argued that the policy goals underlying the filing requirement are unlikely to be implicated in consumer consignment transaction. The likelihood that consumers who were delivering goods to a merchant were in fact crafting “a subterfuge for inventory financing” was low.¹⁸⁸ The committee noted that other transactions might also be exempted from the UCC filing requirement, specifically citing “delivery for sale of art by an artist to an art dealer.”¹⁸⁹

In a footnote, the study group noted that the filing requirement might not be unreasonably onerous for some knowledgeable consumers, giving as an example “a sophisticated art collector who consigns art to a gallery.”¹⁹⁰ The study group’s suggestion might have been founded on a misconception that the art market is interchangeable with other financial markets and that one’s behavior in financial dealings automatically translates to one’s behavior in art dealings. Although commercially sophisticated actors are prominent players in the art world, they often conduct their business in the art world from an entirely different perspective.¹⁹¹ An in-house counsel at an auction house noted that the art world often elicits different behavior from commercial actors: “Business people who would never think of buying a house without a contract will spend the same money on a painting without checking on who actually owns it or who lent money against it.”¹⁹² Collectors in this sense are often acting in a personal capacity and are much more similar to the consumers the

186. PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, REPORT OF THE ARTICLE 9 STUDY COMMITTEE 187 (1992).

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.* at 188 n.7.

191. *See supra* note 5.

192. John Dizard, *The Murky World of Art Finance*, FT.COM, Apr. 12, 2008, <http://www.ft.com/cms/s/0/6bc14b76-0820-11dd-a922-0000779fd2ac.html> (quoting an in-house lawyer at an auction house).

Article 9 study group wanted to protect.¹⁹³ Dispensing with the filing requirement and extending statutory protection to collectors would be consistent with the intent of the drafters.

CONCLUSION

As the Berry-Hill and Salander consignors-collectors can attest, using the same bankruptcy standards to evaluate the consignment of screwdrivers and the consignment of artwork is misguided.¹⁹⁴ Allowing third-party creditors to attach consigned goods in bankruptcy was originally intended to protect creditors from being duped into lending money on the promise of collateral that was secretly tied up by other commitments.¹⁹⁵ The art trade is founded on consignment. The fact that many dealerships consign artwork is hardly secret, so the concern that drove the policy of allowing third-party creditors to attach consigned property seems misplaced in the art gallery context.

The UCC filing system and its requirements were an attempt to provide consignors a means to alert creditors of their rights in collateral. In a hardware store context, the UCC filing represents a reasonable means to flag inventory that may be on consignment. The customs of the art world, however, do not mesh as well with the concrete paperwork and filing requirements of the UCC.

In recognizing that artwork stands apart from the consignment of other goods, bankruptcy courts should not mechanically apply the general consignment rule to consigned artwork. States have already responded to the unique demands of consigned art in statutes that create trusts for artwork consigned by artists to dealerships. Another possible response would be creating a presumption that art galleries are generally known to sell consigned goods and modifying the effect of proving the generally known exception so that it allows consignors to block creditors from seizing their work in bankruptcy. With art consignment being a customary practice in the art industry, the

193. See PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, *supra* note 186, at 187 (recommending changes to protect consignors from the unreasonable burdens of UCC filing).

194. See *A Dealer and Collector Describes His Experiences with Berry-Hill*, *supra* note 30 (“[U]nfortunately, the law treats the consignment of art to the gallery the same way they would treat the consignment of screwdrivers to a shop.” (quoting the Hon. Joseph P. Carroll)).

195. U.C.C. § 2-326 cmt. 2 (2000) (limiting application of the section to “cases in which creditors . . . may reasonably be deemed to have been misled by the secret reservation”).

expectation should be that some of the work in an art gallery is consigned. Third-party creditors, not art consignors, should bear the burden of showing that a gallery's consignment practice was not generally known by creditors. Moreover, proving the exception should be sufficient for the consignors to keep their artwork out of bankruptcy proceedings; they should not be forced to continue fighting for their paintings under section 2-326 and common law bailment principles. Adopting such changes would help ensure that the law appreciates both the tangible and intangible value of artwork and that consigned artwork is not merely treated as another piece of hardware.¹⁹⁶

196. See *A Dealer and Collector Describes His Experiences with Berry-Hill*, *supra* note 30 (discussing the law's similar treatment of consigned screwdrivers and consigned artwork in bankruptcy).