WASHINGTON SUPREME COURT

No. 1039395

Kenneth Wren and Alice Wren, et al.
Petitioners.

vs.

David G. Whitehead individually;
Respondent,

Stanford & Sons, LLC, a Washington limited liability company;
Herbert L. Whitehead, III, Jennifer L. Whitehead, et al.

AMICUS CURIAE MEMORANDUM SUPPORTING THE PETITION FOR REVIEW

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STATEMENT OF THE FACTS

In 2016 and 2017, Kenneth Wren ("Wren") loaned a total of $1.7 million to Stanford & Sons, LLC, a car dealer (Stanford"). Court of Appeals Decision (hereinafter "Decision") at 5, 8. The loans were secured by a perfected security interest in Stanford's existing and after-acquired inventory. *Id.* at 6. Both before and after making these loans, Wren received balance sheets detailing Stanford's finances. These balance sheets included a line item for "Consignor Inventory." *Id.* at *8.

Beginning in 2018, Gage Whitehead ("Whitehead") purchased 81 used vehicles and consigned them to Stanford, including the 12 vehicles that are at issue in this appeal. Whitehead never filed a financing statement, *id.* at *11. After Stanford defaulted on the loan from Wren, Wren and Whitehead disputed ownership of 12 vehicles consigned by Whitehead.

Wren moved for partial summary judgment, claiming that his perfected security interest in the vehicles was superior to any

interest Whitehead had as a consignor. *Id.* at *22. The trial court denied the motion. *Id.* at 23.

The jury determined that, although Wren was unaware that Whitehead was consigning vehicles with Stanford, Wren was aware that Stanford was substantially engaged in selling consigned goods. The jury therefore awarded Whitehead the 12 vehicles in dispute. *Id.* at *25.

Wren appealed, arguing, among other things, that the trial court erred in denying his motion for summary judgment regarding the 12 vehicles in dispute and in refusing to give the jury instruction he had requested regarding a disputed fact relating to whether Whitehead's transaction with Stanford was a "consignment" governed by Article 9 of the Uniform Commercial Code (as enacted in Washington). *Id.* at 61. The Court of Appeals affirmed, concluding that Whitehead's transactions with Stanford was not such a "consignment." *Id.* at *61-69. Noting that the definition of "consignment" in §

9-102(a)(20)[1] excludes a transaction in which the consignee is "generally known by its creditors to be substantially engaged in selling the goods of others," the Court of Appeals, like the trial court before it, concluded that because Wren – and only Wren – was aware that Stanford was selling consigned goods, the transaction between Whitehead and Stanford was not a "consignment" governed by Article 9, Whitehead's rights were not subject to Article 9's priority rules, and Whitehead was entitled to the 12 vehicles. *Id.*

[1] For simplicity and ease of reading, the citations in this brief to the Uniform Commercial Code omit a parallel citation to the Washington Commercial Code, which is identical unless expressly indicated otherwise.

ARGUMENT

Article 9 Applies to Most Consignments of Goods Because the Consignor's Retention of title is Invisible to the Consignee's Creditors, Potentially Misleading Them into Believing that the Consignee Owns the Goods

Since its inception, the UCC has treated a conditional sales contract – by which a seller of goods retains title to delivered goods until full payment is received – as creating a security interest. *See* UCC §§ 1-201(b)(35), 2-401(1). The reasons are twofold. First, the purpose of retaining title is to be able to assert ownership of the goods, and reclaim possession of them, if timely payment is not received. The purpose of a security interest is the same. Second, title is invisible. Specifically, absent some legal protection, creditors of the buyer would have no ready way of ascertaining that the buyer does not own all the property rights in goods in the buyer's possession. By treating retained title as a security interest governed by Article 9, the drafters gave sellers an incentive to file a financing statement that provides public notice of their retained rights in the goods.

The reasons Article 9 applies to most consignment transactions are much the same. In a consignment, the consignor delivers goods to the consignee but retains ownership – *i.e.*, title. It would be fairly simple for a manufacturer or wholesaler that sells goods on credit to retailers to structure the transaction as a consignment, rather than as a sale. The transactions are largely the same; the one exception being that, instead of making payment due by a specified date, it would not be due until after the buyer resold the goods.[2] Hence, from its inception, the UCC required consignors to comply with Article 9's filing rules or risk losing the consigned goods to the creditors of the consignee.[3]

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[2] *See In re Truck Accessories Distrib., Inc.*, 238 B.R. 444, 448 (Bankr. D. Ark. 1999).

[3] Prior to the revision of Article 9 in the 1990s, **Error! Main Document Only.**and confirmatory amendments to Article 2, a substantially identical provision was in UCC § 2-326(3).

An Exception Applies If the Consignee Is Generally Known by its Creditors to Be Substantially Engaged in Selling Consigned Goods

There is – and always has been – an exception. Article 9 does not apply to a consignment if the consignee "is generally known by its creditors to be substantially engaged in selling the goods of others." § 9-102(a)(20)(A)(iii).[4] The premise underlying this exception is that, if the consignee's creditors already know that the consignee regularly sells consigned goods – that is, goods owned by others – they are unlikely to be deceived into thinking that the consignee owns all the goods in the consignee's possession, and hence unlikely to extend credit based on the those goods. Because Article 9 does not apply in such a circumstance, the consignor need not file a financing statement to provide public notice of the consignor's retained interest in the goods delivered to the consignee.

[4] Section 2-326(3) referred to "his creditors," rather than "its creditors," but was otherwise identical.

The Courts Below Misapplied the Statutory Text by Focusing on What a Single Creditor Knew

In concluding that Article 9 does not apply in this case, the Court of Appeals quoted and italicized the relevant statutory text – which deals with whether a consignee is "generally known by its creditors to be substantially engaged in selling the goods of others" – but then disregarded the plain language by basing its decision on what a single creditor knew. In doing this, the Court of Appeals cited to two cases. *See* Decision at 66-67 (citing *In re Valley Media, Inc.*, 279 B.R. 105 (Bankr. D. Del. 2002); *Fariba v. Dealer Servs. Corp.*, 100 Cal. Rptr. 3d 219 (Cal. Ct. App. 2009)).

The *Valley Media* case actually ruled to the contrary, stressing multiple times that the test is what a majority of the consignee's creditors know. *See* 279 B.R. at 124-25 & 131-32. The *Fariba* decision is, by and large, an aberration in the case law, and is simply wrong.

Shortly after the *Fariba* court issued its ruling, Professor Stephen Sepinuck sharply criticized the court's opinion,

explaining that the court did not seem to understand how problematic its analysis might become:

> Under the court's view, the nature of a transaction between A and B (a consignor and consignee, respectively) – and the law that governs it – is determined by what C (a creditor of B) knows. The court gave no consideration to the fact that there may be multiple Cs, some of whom know the nature of B's business and some of whom do not. In such a case, the consignment transaction between A and B would apparently be both inside and outside Article 9. Presumably this could lead to circular priorities, with no logical way to break the circle.

Stephen L. Sepinuck, *Misguided California Court Changes "Consignment" Standard*, 25 CLARKS' SECURED TRANSACTIONS MONTHLY 1, 2-3 (Sep. 2009). A few months later, Steven Weise, the ABA Advisor to the Drafting Committee that revised Article 9 in the 1990s, agreed, writing that the *Fariba* decision "is quite contrary to the language of Article 9" and "could lead to circular priorities – with the same transaction inside the scope of Article 9 for some creditors of the consignee and outside the scope of Article 9 for others." Steven O. Weise, *Annual Survey*

of Commercial Law: Personal Property Secured Transactions, 65 BUS. LAW. 1293, 1294 (2010).

The vast majority of courts addressing the issue – both before and after *Fariba* – apply the statutory language as written, requiring proof that creditors of the consignee generally know, not what a particular creditor or litigant knew.[5] The only known cases adopting the *Fariba* court's approach – other than the Court of Appeals below – are a trio of decisions by a bankruptcy court in the same case: *In re TSAWD Holdings, Inc.*, 595 B.R. 676 (Bankr. D. Del. 2018); 2018 WL 6885922 (Bankr. D. Del. Nov. 26, 2018); 601 B.R. 599 (Bank D. Del. 2019).

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[5] In addition to the *Valley Media* case mentioned above, see *Overton v. Art Fin. Partners LLC*, 166 F. Supp. 3d 388, 410 (S.D.N.Y. 2016); *Rayfield Inv. Co. v. Kreps*, 35 So. 3d 63 (Fla. Ct. App. 2010); *In re Niblett*, 441 B.R. 490, 493 (Bankr. E.D. Va. 2009); *In re Downey Creations*, LLC, 414 B.R. 463, 471 (Bankr. D. Ind. 2009).

Courts similarly interpreted § 2-326(3), the predecessor to § 9-102(a)(20). *See, e.g.*, *In re Wedlo Holdings, Inc.*, 248 B.R. 336, 341 (Bankr. N.D. Ill. 2000); *In re Wicaco Mach. Corp.*, 449 B.R. 340, 343-44 (E.D. Pa. 1984); *In re Alper-Richman Furs, Ltd.*, 147 B.R. 140 (Bankr. N.D. Ill. 1992).

That court went so far as to say that it would be "absurd" for a secured creditor that had knowledge of the consignment to have priority over the consignor simply because the other creditors of the consignor do not have that knowledge. 595 B.R. at 682.

Putting aside the incredible hubris it takes to declare as absurd a provision of the UCC, which is drafted over a period of years by a large committee of experts and then approved by the full membership of both the American Law Institute and the Uniform Law Commission, it appears that the *TSAWD Holdings* court failed to comprehend what was at issue. The knowledge test in § 9-102(a)(20) is *not* a priority rule, it is a definition relating to the scope of Article 9.[6] The court's approach, like the

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[6] As explained in an article excoriating the rulings in *TSAWD Holdings*, "[t]he drafters of Article 9 were well aware of how to phrase a rule based on a particular person's knowledge, and did so in more than a dozen different provisions. *See* U.C.C. §§ 9-317(b), (c), (d), 9-320(b), 9-321(a), 9-323(b), (d)-(g), 9-330(b), (d), 9-337(1), (2); *see also* U.C.C. §§ 9-320(a), 9-321(b), (c), 9-341(2) (each expressly treating a claimant's knowledge as irrelevant)." Carl S. Bjerre & Stephen L. Sepinuck, *Spotlight*, Commercial Law Newsletter 8, 10-11 (Aug. 2019).

approach of the *Fariba* court before it, means that a single consignment transaction can be simultaneously both inside and outside the scope of Article 9, depending on what each of two or more competing creditors happens to know. That is simply an unworkable situation.

Most important, in the interval between the various rulings in *TSAWD Holdings*, the Permanent Editorial Board for the UCC ("PEB") issued a commentary rejecting the *Fariba* court's approach and confirming that the test is what creditors of consignee generally know, not what any individual creditor knows. *See* PEB Commentary No. 20, at 5 & n.29 (Jan. 24, 2019). The PEB explained that, if the law were as the *Fariba* court interpreted it, a given transaction would be subject to Article 9's perfection and priority rules vis-à-vis creditors without knowledge of the consignment but excluded from Article 9 as to creditors with knowledge, leading to difficult priority disputes "without promoting any Article 9 policy." *Id.*

Accordingly, the PEB amended Official Comment 14 to § 9-102 by adding the following paragraph:

> Under clause (iii) of subparagraph (A), a transaction is not an Article 9 "consignment" if the consignee is "generally known by its creditors to be substantially engaged in selling the goods of others." Clause (iii) does not apply solely because a particular competing claimant knows that the goods are held on consignment.

Although the PEB is not a court, it was created by the American Law Institute and the Uniform Law Commission to issue commentaries that reflect the correct interpretation of the UCC and advance the uniformity and orderly development of commercial law. While state courts undoubtedly have the final say on the meaning of their own state's law, the PEB is the ultimate authority on the meaning of the *Uniform* Commercial Code.

CONCLUSION

In its opinion below, the Court of Appeals noted that "[o]ne of the primary purposes in Washington's adoption of the UCC is to 'make uniform the law among the various

jurisdictions.' " Decision at 62 (quoting UCC § 1-103(a)(3)). Unfortunately, its decision will have the opposite effect. By adopting a non-textual reading of the statutory language – a reading criticized by the country's leading experts on Article 9, rejected by most other courts that have addressed the issue, and disavowed by the Permanent Editorial Board – the decision below will not only perpetuate a misunderstanding, it will undermine the goal of uniformity.

For these reasons, *amicus curiae* requests that this Court grant the petition for review, reverse the portion of the Court of Appeals' decision ruling that the transaction was not a consignment within the meaning of the UCC, and remand the case for further proceedings.

Respectfully Submitted,

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CERTIFICATION OF COMPLIANCE

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