

In re Steven Wallace

Sample Answer

MEMORANDUM

TO: Eva Morales
FROM: Applicant
RE: Steven Wallace—"Hare Castle" Painting

INTRODUCTION

In this case we must show that our client, Steven Wallace, is entitled to retain possession of his painting, "Hare Castle," and that he is not obligated to turn the painting over to the Trustee in Bankruptcy. We must prove that either (i) the painting is not an asset or part of the inventory of Artists' Exchange, or (ii) if the painting is an asset, it is still exempt from the interests and claims of Artists' Exchange's creditors because the consignment is subject to at least one of the four defenses provided in section 2-326(3) of the Franklin Commercial Code ("FCC"). Part I of this memorandum will examine the first issue and analyze the legal and factual bases of the trustee's claim that the painting is an asset of the bankruptcy estate of Artists' Exchange. Part II will discuss the four defenses under the FCC in relation to the facts of our client's case.

I. IS "HARE CASTLE" AN ASSET OR PART OF THE INVENTORY OF ARTISTS' EXCHANGE?

Under FCC section 2-326(3), where goods are delivered to a person for sale, and such person maintains a place of business dealing in goods of the kind involved under a name other than the name of the person making the delivery, the goods are deemed to be on "sale or return." This is so *even though* the agreement purports to reserve title to the person making delivery until payment or resale, or uses a word such as "consignment." This rule was applied in *First National Bank v. Marigold Farms, Inc.*, where Marigold regularly delivered flowers to Pacific Wholesalers for resale. If Pacific sold the flowers, Marigold was given 75% of the proceeds. If Pacific did not sell the flowers, the flowers (because they were perishable) were discarded with Marigold's permission, and Marigold did not receive any money. The court concluded that the flowers became part of Pacific's inventory upon delivery by Marigold because they were held by Pacific for sale, and that retention of title by Marigold was irrelevant to the ability of another creditor (the bank) to obtain a security interest in the goods.

It is clear that our client delivered "Hare Castle" to Artists' Exchange on consignment. Mr. Wallace expressed his belief that most of the art in Artists' Exchange was on consignment from artists. Furthermore, he took steps to assure that he would retain title to the painting by labeling the back of the painting and by signing the inventory receipt that contained the explicit language that he would retain title and the right to accept or reject offers. Therefore, this was a sale on consignment.

However, a court applying FCC section 2-326(3) would find the arrangement to be a sale or return, and under the *Marigold Farms* case would conclude that once Mr. Wallace delivered "Hare Castle" to Artists' Exchange, the painting became part of the shop's inventory. This conclusion would also be supported by the fact that the receipt signed by our client included the words "Inventory Receipt" in large print near the top. Our client's steps to retain title would probably be viewed as irrelevant with respect to a creditor's claim.

Thus, "Hare Castle" is an asset of Artists' Exchange, is subject to the requirements of the Bankruptcy Act, and is under the exclusive control of the Trustee in Bankruptcy.

There is an issue we need to examine. Section 549 of the Bankruptcy Act states that the trustee may avoid a transfer of property that *occurs after commencement* of the case. Our file notes are unclear as to the exact date that the painting was returned to Mr. Wallace, but it appears that it was about July 16 or 17, 1999. The Chapter 7 case commenced on July 19, 1999. Therefore, it is arguable that the transfer of the painting occurred before commencement of the case. However, the Chapter 11 case commenced on May 25, 1999, well before the transfer. We need to research to see which date is relevant for purposes of section 549—the date of the Chapter 7 case or the date of the original Chapter 11 case.

II. DOES STEVEN WALLACE HAVE A DEFENSE UNDER FCC §2-326(3)?

This section will examine the defenses separately and the relevant helpful facts:

A. Sign Law

To take advantage of the defense contained in section 2-326(3)(a), there must be an applicable sign law. Franklin has such a law. [Franklin Civil Code §3533] For the sign law to apply to our client's case, we must prove that Lottie Zelinka, the owner of Artists' Exchange, posted an easy-to-read, conspicuously placed sign in the shop that (i) states that Artists' Exchange deals in property in which others have an interest and (ii) identifies such property. Mr. Wallace believes that there is a sign at the front of the store stating that all offers would be forwarded to the artists; however, he is not *positive* that such a sign exists. Nor do we know whether that language is adequate to notify parties that others have an interest in the artwork in the shop and whether it identifies the particular property. There is also a question of whether Ms. Zelinka owns some of the items. At this point, we need to determine whether there actually is a sign in the shop and exactly what it says. We can determine this by asking Ms. Zelinka, although we may have to go through her attorney as well as the trustee. One of our law clerks could also pay a visit to the shop to see if there is a sign and where it is located, although we may have to proceed through the same channels for permission to enter the shop. Hopefully, we can get pictures of the sign. We also need to find out from Ms. Zelinka or the trustee if all items for sale in the shop are owned by the artists and are there on consignment. Furthermore, we need to review other sign cases regarding visibility and notice issues.

B. Establishing that Artists' Exchange Is Generally Known by its Creditors to be Substantially Engaged in Selling Goods of Others

To be entitled to this defense [FCC §2-326(3)(b)], a consignor must establish that a consignee is "generally known by his creditors to be substantially engaged in selling the goods of others." We must determine who Ms. Zelinka's creditors are. If they are mainly consignors, then clearly they would know that she sells goods of others. We could ask Ms. Zelinka, her attorney, or the trustee about her creditors, and probably we could find out information from the bankruptcy petition and court records.

If the majority of her creditors are not consignors, based on *Marigold Farms*, we would have to show that these nonconsignor creditors knew that she substantially sold the goods of others. We need to determine whether it is a well-known fact (or common knowledge) that *many or most* art-galleries sell the goods of others. The knowledge that most galleries operate on consignment arguably could be imputed to creditors of Artists' Exchange, regardless of whether they are artists. We should be able to determine this rather easily by calling

the various galleries in the area and by contacting an expert in the field of art dealing. We should also contact other artists and ask them and perhaps peruse their contracts. We should also talk to other creditors and review the Artists' Exchange's advertising to see whether it indicates a consignment arrangement.

Also lending support to our position is the sign that our client believes is posted in the shop and possibly the labels on the backs of the paintings, although the court in *In re Levy* held that cards placed on certain sections of shelving where a consignor's shoes were displayed were not adequate. Again, we need to check all the details of the sign and see whether labels exist on all the consigned paintings. We should also check on how long Ms. Zelinka has been operating the gallery to see how well-known it is and, consequently, how well-known its practices are.

C. Compliance with FCC Article 9

Nothing in our facts indicates that our client filed any financing statements or other documents pursuant to FCC Article 9. [FCC §2-326(c)] Thus, this defense is inapplicable to our client's case. However, we should ask Mr. Wallace to be sure that he did not file.

D. Goods Used for Personal, Family, or Household Purposes

Section 2-326(3)(d) provides a defense for persons who do not normally deal in consignments, but may occasionally deliver an item to a consignee for resale. It does not apply to a merchant, who we can define as one who normally deals in the goods delivered to the consignee. Facts that would support our use of this defense include the fact that "Hare Castle" was a painting that Mr. Wallace created for his own pleasure and not for sale, it originally hung in his dining room and was hanging there for two years, and he never thought about trying to sell it before Ms. Zelinka approached him with the idea. The fact that Mr. Wallace and his wife selected and bought a carpet to coordinate with the colors in the painting strengthens our argument that "Hare Castle" was intended for personal use (enjoyment) by the Wallace family.

Also, we should argue that while Mr. Wallace had previously sold a few of his works, he did not deal in the sale of his artwork on a regular basis, certainly not regularly enough to be considered a merchant. We can use his statement that he could not believe that his paintings were jeopardized every time he put them up for sale in a gallery to support that he was unaware of the FCC rules affecting merchants and therefore had no idea of the possible consequences of entering into a "sale or return" situation. We should also confirm Mr. Wallace's beliefs by talking to his wife and other family members and friends who are aware of the situation. Although Mr. Wallace is now creating artwork full time, this is irrelevant to his position at the time of the transaction at hand.

Thus, depending on what our investigation shows about the sign and the creditors' knowledge, we may have those defenses available to us. At this point, however, our best defense appears to be the personal use defense.