Beware: Selling Vehicles on Consignment Can Be Risky Business

▶ *TAKE PRECAUTIONS TO AVOID LOSSES*

Selling vehicles on consignment without taking proper precautions may cause dealers to lose ownership and/or the proceeds of sales from certain vehicles.

What is a consignment and why would a dealer do it?

Under a consignment agreement, the owner of a vehicle, the consignor, retains title and delivers a vehicle to a dealer, the consignee, for sale. The consignee sells the vehicle and remits the proceeds to the owner or returns the unsold vehicle.

For a consignor, the advantages are that it can be an expeditious way to reduce excess inventory, increase sales volume and remove from inventory vehicles that don't necessarily fit with the mix of other vehicles within the dealer's supply of vehicles. For the dealer selling vehicles under a consignment, it enables them to expand and vary their inventory and attract new customers without investing much of their own money.

Dealer-to-Dealer Consignments

In New Jersey, dealer-to-dealer consignments do not need to be in writing. However, to properly protect the consignor's interest in vehicles and the proceeds from any potential sales, the consignment terms should be governed by a written agreement between the consignor and consignee setting forth all necessary terms and conditions such as the amount or percentage the consignor should receive and authority to place all of the consignee's secured lenders on notice of the arrangement.

Consignments are governed in New Jersey by the Uniform Commercial Code. The UCC defines a consignment as a transaction, regardless of its form, in which a person delivers goods to a merchant for purposes of sale and (A) the merchant deals in goods of that kind under a name other than the name of the person making the delivery, is not an auctioneer and is generally not known by its creditors to be substantially engaged in selling goods of others; (B) the aggregate value of each delivery of goods is $1,000 or more at the time of delivery; (C) the goods are not consumer goods immediately before delivery and (D) the transaction does not create a security interest that secures an obligation.

The consignor should file a UCC financing statement describing the goods in New Jersey in order to protect its interest in the vehicles. It should also send an authenticated notification to the holders of any other security interests in the consignee's inventory advising that the consignor has or expects to acquire a consignment interest in certain vehicles.

In the absence of taking the above described steps, floor plan financers or other lenders can have interests in a consignor's vehicles that are superior to the consignor's interests regardless of whether the wholesaler/consignor retains titles.

Typically, a floor plan financer or other lender secures the repayment of a line of credit given to a car dealer by taking a security interest in the consignee's inventory. That security interest is perfected in New Jersey by way of filing a UCC financing statement with the New Jersey department of treasury. A floor plan financer or lender's security interest usually gives the lender an interest in the car dealer's entire inventory and any proceeds therefrom, not just the inventory acquired using the line of credit from the lender or floor plan financer.

Under the UCC as adopted in New Jersey, a consignment is an unperfected security interest unless the consignor has also filed a financing statement with the New Jersey department of treasury. The law in New Jersey and elsewhere is such that the interests of a consignor who does not file a financing statement are inferior to the interests of a perfected inventory financer or perhaps even a bankruptcy trustee.

In other words, a consignor that has title to a vehicle can lose ownership and not recover any compensation for the vehicle under certain circumstances. Specifically, in the event the consignee defaults on its floor plan line of credit or other obligations to a secured lender, the inventory can be taken by the floor plan financer or lender whose interest is superior to the title owner if it has no way of knowing that the vehicles are consigned unless the consignor files a financing statement and gives the party with an already filed financing statement holding such a security interest actual notice of the consignment. In that case, the inventory is still subject to a prior creditor's perfected security interest.

A consignor can obtain priority over a pre-existing floor plan financer or lender's lien if it files a UCC financing statement and gives written notice to the floor plan financer or lender before the filing stating that it expects to deliver vehicles on consignment to the consignee. There is case law in New Jersey that a consignor that files a financing statement but does not give written notice to the lender of the consignments still loses its priority and ownership to its vehicles.

Retail Consumer-to-Dealer Consignments

The UCC has not defined consignments to include all true consignments and makes several exceptions in consumer owned and used vehicles. If a used motor vehicle is a consumer vehicle immediately before delivery to a consignee, then, in most cases, the consumer consignor remains the owner of the vehicle and its rights in the vehicle and the proceeds of its sale are superior to those of a floor plan financer or lender.

For New Jersey dealerships that sell vehicles consigned by retail consumers, there is no legal requirement to enter a written agreement. However, in order to mitigate confusion, hard feelings or lawsuits that could include claims of breach of contract, consumer fraud and fraud, it would be prudent to have a consignment contract for the vehicle executed and signed by the dealer and the consignor.

The consignment contract should include all material terms, such as the following: name and address of the retail owners; name and address of the selling dealer; complete description of the vehicle by year, make, model and VIN; net amount or the percentage the consignor is to receive if the vehicle is sold; date by which the vehicle will be returned to the consignor if not sold; disclosure of all unsatisfied liens on the vehicle and an understanding as to when and how title to the vehicle will be turned over to the consignee.

While there may be some additional paperwork and nominal expense involved in selling vehicles on consignment the correct way, dealerships can benefit greatly. Consignors can increase sales volume, reduce excess inventory and maximize exposure for vehicles not within their ordinary mix of vehicles held for sale and consignees can increase sales and profits with low capital investment.

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