

CONSIGNMENT TRANSACTIONS (Ontario and Quebec)

WHAT IS A CONSIGNMENT?

A consignment is a transaction in which a wholesaler, manufacturer or other person supplying goods ("**consignor**") supplies goods to a vendor ("**consignee**") for sale by the consignee without transferring ownership in the consigned goods to the consignee. The essence of such a transaction is that the title in the goods sold moves from the consignor as owner to the ultimate customer of the consignee, with the consignee itself being merely the conduit through which the sale occurs. As a result, there is no "sale" by the consignor to the consignee. Since the consigned goods remain the property of the consignor, they are not subject to seizure by creditors of the consignee.

Consignment arrangements, being private contractual transactions between two parties, fall under provincial jurisdiction and are subject to provincial laws and case law. We focus in this article on Ontario and Québec. Neither of these provinces has enacted a specific law or particular legal provisions regulating consignment. Therefore, general contract principles, as well as principles developed by case law, will apply to consignment arrangements. These principles are very similar in both Ontario and Québec.

On a practical level, regardless of what is set out in an agreement, invoice or other documentation between a consignor and a consignee about who retains title or ownership of the goods, the consignee's creditors will likely consider any goods found to be in the consignee's possession to be goods belonging to the consignee and therefore subject to seizure and liquidation by the creditors. A secured creditor who finds a warehouse full of merchandise will make every effort to establish that the merchandise is, in fact, the property of the debtor (*ie.* that the arrangement between the supplier and the debtor is not a consignment but

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a sale on credit). It is therefore essential that the structure of a consignment transaction be found to be a "true" consignment and not a disguised form of sale on credit (or, according to Ontario legislation, a "consignment intended as security").

Characteristics of consignment transactions

A simple statement on shipping or other documents that the goods have been "delivered on consignment" is insufficient to establish that a true consignment arrangement exists. Case law has identified a number of characteristics which are considered requirements of consignment arrangements.

In Ontario, the following criteria have been established by case law:

- (a) the consignee must keep the goods separate from other goods that are not the property of the consignor. It is advisable that warehouse storage areas containing consigned goods be fenced-off or otherwise set apart and clearly labelled to contain products that are the property of the consignor. The consignor should have access to these locations and should check the goods on hand at regular intervals;
- (b) the consignee should be responsible only for payment of consigned goods that have been sold and should be under no obligation to pay the consignor for goods that have not been sold;

- (c) the consignee should have the right to return unsold goods at any time, and the consignor should have the right to demand the return of the consigned goods at any time;
- (d) after selling the goods, the consignee should regularly account to the consignor for all sales of consigned goods, after deducting the consignee's compensation;
- (e) the consignee should keep all proceeds received from the sale of consigned goods separate from other funds of the consignee (*eg.* a separate bank account in trust for consignor);
- (f) consigned goods should continue to be at the risk of the consignor (*ie.* the consignor should maintain insurance on consigned goods or the consignee should insure the goods at the consignor's expense).

There is case law indicating that the absence of some of these characteristics does not mean that a true consignment does not exist.

The Quebec criteria developed by case law is similar to that of the Ontario case law. The following criteria for the existence of a consignment have been elaborated in Québec:

- (a) the conclusion of an agreement or contract;
- (b) the identification of the consigned goods in a way as to avoid confusion with the consignee's other goods;
- (c) maintaining a separate accounting enabling the identification of the sales proceeds of the consigned goods as opposed to those of the other sales in the course of the consignee's business;
- (d) the price is not payable until after the sale of a good by the consignee;

- (e) the return of the unsold goods to the supplier;
- (f) the behaviour of the parties in the execution of the "consignment" contract is in compliance with the terms of the contract.

Whether the transaction takes place in Québec or Ontario, the criteria listed above should be clearly set out in a formal written consignment agreement. Also, it should be supported by supplementary documents and actual conduct of the parties that is consistent with the arrangement. Purchase orders, acknowledgements, shipping documents and, in particular, all accounting-based documents, should mesh with the consignment arrangement created by the agreement. In determining whether a transaction is a true consignment, courts will look not only at the language of the agreement between the consignor and the consignee, but will also examine the conduct of the parties to determine what their intentions were with respect to the transaction. Courts have gone so far as to examine the consignor's internal accounting treatment of the goods. A consignor should therefore not treat the consigned goods as goods that have been "sold" to the consignee by invoicing the consignee, entering the goods as sold in its books, or making demands for payment of consigned goods that have not been sold by the consignee.

It is important to remember that if the consignor fails to regularly confirm that the consignee is satisfying the requirements set out above (*eg.* as to separation of consigned goods), the validity of the consignment arrangement may be jeopardized. It is also important that there be no contradiction between the consignment agreement and any other agreement entered into between the consignor and the consignee. This may be particularly difficult in situations where the consignee is also purchasing goods directly from the consignor (whether they be the same as or different from the consigned goods). Will a creditor of the con-

signee be able to determine which of such goods in the consignee's possession are the property of the consignee and which are the property of the consignor? Courts have rejected claims that a consignment exists in cases where it was found that goods originally delivered on consignment were sold and replaced with goods that were then mixed with other, non-consignment, inventory in such a way that no one could identify specific items and prove that they were held on consignment.

In the event of a bankruptcy or other financial failure of the consignee, a properly established consignment arrangement will allow the consignor to reclaim any unsold goods that are still on the consignee's premises and, if applicable, collect any funds held in trust by the consignee from the sale of consigned goods. However, as mentioned above, the enforcement of a consignor's rights may not be automatic.

As also referred to above, there is no legislation in place in Ontario that specifically sets out and guarantees the rights of consignors. A consignor should therefore expect to have to defend its interest before the courts, as the consignment arrangement may be questioned or challenged by trustees in bankruptcy, receivers and secured creditors who take over control of the consignor's assets on bankruptcy or receivership.

In the province of Quebec, if the contract provides that the consignor remains the owner of the consigned goods until the sale and the payment of same, and the consigned property can be described in a way as to be easily identifiable (usually by a serial number), a registration of the consigned property can be made at the Movable Rights Registry. This registration will notify third parties (such as the consignee's bank, in whose favour the consignee might grant a movable hypothec on his inventory in order to secure financing) that the consigned goods do not belong to the consignee. This is recommended so as

to increase the protection of the consignor in case of a seizure by a third party creditor.

Consequences of not fulfilling the criteria

Where the terms of transactions between a consignor and a consignee do not satisfy the criteria described above, it is possible that the arrangement will be found to be a "false" consignment or a "consignment intended as security" or a sale on credit. In other words, the arrangement will be seen as an agreement that was intended to secure the payment or performance of an obligation on the part of the consignee. The end result of such a finding will be that, if the consignor has not perfected its interest in the consigned goods in accordance with the requirements of any applicable personal property security legislation, the goods will be subject to seizure by secured creditors and the consignor will become an unsecured creditor of the consignee.

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