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ARTICLES 7 AND 9 OF THE UNIFORM COMMERCIAL CODE—SECURITY INTERESTS IN THE WAREHOUSEMAN'S OWN Receipts COVERING FUNGIBLES

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Among the vast introductory commentary on Article 7 of the Uniform Commercial Code, there is little specific attention devoted to either warehouse receipts or the interrelationship of Article 7 with

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2 An exception is Boshkoff, The Irregular Issuance of Warehouse Receipts and Article Seven of the Uniform Commercial Code, 65 Mich. L. Rev. 1361 (1967). Those cases that have been decided are collected in an annotation on the construction and effect of Uniform Commercial Code Article 7 in 21 A.L.R. 3d 1339 (1968).
Article 9. One specific transaction which involves both of the above topics is the lending of money by banks to warehousemen on the security of warehouse receipts. This transaction has not been the subject of appreciable commentary despite the early codification of rules by the Uniform Warehouse Receipts Act.

A warehouseman who is also a dealer in the fungibles he stores, like any other businessman, may need to borrow money. Like any other businessman, he has a readily available source of collateral in his stock in trade. The warehouseman approaches the banker who agrees to lend him money on the security of his inventory. The banker, realizing that a pledge by delivery of the warehouseman’s grain is impractical, agrees to accept the warehouseman’s own receipts and to hold these documents of title as collateral.

The agreed-upon payment terms usually provide for the release of the collateral by the bank to the warehouseman so that he can sell the grain and use the proceeds to repay the bank in liquidation of the debt. From the banker’s point of view, a safe and profitable loan has been consummated. From the warehouseman’s vantage, a workable solution to his capital needs has been effected. Lawyers, by nature or necessity, are captious and pessimistic. So for the lawyer who must advise the banker beyond the “principle” agreement, the banker and the warehouseman have, by this simple transaction, created an intractible maze.

After preliminary research on documents of title, security interests, warehouses and warehousemen, priorities, bankruptcy, administrative law and statutory construction, the lawyer must isolate the following questions to be answered before he can give the banker practical advice about handling the details of the proposed transaction:

1. Can a warehouseman make a valid pledge of his own warehouse receipt for fungible goods contained in his warehouse?

2. Does the Uniform Commercial Code wholly circumscribe the relations of the parties to the transaction or are there state and federal laws with substantive bearing?

3. If there is a default in the loan and it results in insufficient goods in the warehouse to cover all receipts outstanding in the hands

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3. An exception is BRAUCHER, parts of which are concerned with this topic.

4. The Uniform Warehouse Receipts Act [hereinafter cited as U.W.R.A.] was recommended in 1906 and eventually enacted in all jurisdictions. See S. WILLISTON, SALES § 406a (rev. ed. 1948) [hereinafter cited as WILLISTON].
of depositors, holders and other lenders, who will share in remaining goods and in what proportion?

4. Is it necessary to verify the authority of the agent or employee who signs the warehouse receipts which are to be pledged?

5. How does the bank perfect its security interest in the receipts and goods?

6. What can be done by the bank to insure its preferred position as a creditor in both the collateral when released to the warehouseman for sale or shipment and the proceeds from the sale of that collateral?

The first four questions, dealt with in Part I, involve close consideration of Article 7 of the Code and are ancillary to, but inseparable from, the last two questions. Those two questions involve the problem of maintaining and enforcing the bank’s security interest and will necessitate a shift in the frame of reference to Article 9 of the Code. Perfecting a security interest and establishing a system of control so that the banker is always assured of his position involve considerations not necessarily peculiar to warehouse receipts. Part II of this article consequently contains a discussion of secured transactions broader in scope than the pledge of specific documents.

I. THE LEGAL FRAMEWORK

A. Issuance and Pledge by the Warehouseman of Receipts for Goods He Owns

At common law, it was questionable whether a valid security interest or chattel mortgage attached to the pledge by a warehouseman of a receipt for his own property. Validity centered upon the question of whether a true pledge is created by delivery of the receipt while the underlying goods remain in the possession of the pledgor. Jurisdictions upholding such a pledge did so on the basis that although the pledgor had the physical custody of the pledged goods, he held them not in his individual capacity, but as a warehouseman. So viewed, the delivery of the document of title is sufficient delivery of the goods to effect a pledge. On the other hand, jurisdictions denying

the validity of such a pledge did so on analogy to the rule that a chattel mortgage is invalid unless there is either a change of possession of the goods or a filing or recording of the mortgage. Thus, continued dominion over the goods by the warehouseman invalidates the attempted pledge.6

Under the Code and the Uniform Warehouse Receipts Act, a warehouse receipt may be issued by any warehouseman.7 Since a "warehouseman" is defined in the Code as a person engaged in the business of storing goods for hire,8 it follows that a warehouseman can issue valid receipts covering goods owned by him.9 Even ignoring these express provisions, it is clear that both the Code10 and the United States Warehouse Act11 contemplate issuance of receipts for goods which the warehouseman owns.12 There are a few cases that seem to reach a contrary result. Such cases, however, are distinguishable either on the basis that the warehouseman was not engaged in the business of storing goods for hire but was storing his own goods under an invalid field warehouse arrangement or failed to comply with disclosure requirements of state law.13

Awareness of the technical requirements for the form and content of warehouse receipts is important. Such requirements may be imposed from three sources: the Code; other state laws; or federal law (the United States Warehouse Act). Despite Code provisions validating receipts which do not comply with requirements of form, there is substantial danger that the holder of a non-complying receipt may be frustrated by holders of other receipts or by the warehouseman's bonding company by assertions that the document held by the pledgee is not a warehouse receipt.14

7. UNIFORM COMMERCIAL CODE § 7-201(1) (1962) [hereinafter cited as U.C.C.].
8. UCC § 7-202(2)(b).
9. BRAUCHER at 9; 2 WILLISTON § 407(a).
11. 7 U.S.C. § 260 (1964). This is the stated position of the Indianapolis area office of the warehouse service.
12. See Maryland Casualty Co. v. Washington Loan & Bank Co., 167 Ga. 354, 145 S.E. 761 (1928) (but this case expresses doubt as to what a pledgee might hold if the rights of innocent third parties were involved).
13. Central Nat'l Bank of Matoon v. Fidelity & Deposit Co. of Maryland, 324 F.2d 830 (7th Cir. 1963); In re United Wholesalers, Inc., 274 F.2d 316 (7th Cir. 1960); Interstate Banking and Trust Co. v. Brown, 235 F. 32 (6th Cir.), cert. denied, 242 U.S. 632 (1916) (failure to comply with state law); In re Pine Grove Canning Co., 226 F. Supp. 872 (W.D. La. 1963).
14. The problem and effect of irregularity in issuance is fully explored in Boshkoff, supra.
Section 7-401(a) of the Code provides that the obligations imposed by Article 7 on an issuer apply even though:

[t]he document may not comply with the requirements of this Article or of any law or regulation regarding its issue, form or content; . . . .

However, this section does not seem to regulate rights between the holder and third parties. For example, in *Central National Bank of Mattoon v. Fidelity & Deposit Company of Maryland*, a claim on a warehouseman’s bond was made by a creditor who had loaned money to a licensed public grain warehouseman on the security of receipts for goods owned by the warehouseman. The bond was conditioned on the faithful performance of duties as an operator and the unreserved compliance with the laws of the state. The bonding company moved for judgment on the ground that the receipts were illegal on their face as failing to comply with Illinois law which requires receipts for grain, purportedly owned by warehousemen, to state that the grain belonged to the warehouseman and was stored in a separate bin. The bond was held not to cover the receipts in question as the receipts were illegal on their faces.

Particularly in the Midwest, there are laws and regulations beyond the Code regulating the warehouse business. There may even be constitutional provisions. Obviously, there is some chance of conflict between Code requirements and these specialized rules. The Code recognizes this, providing in section 7-103 that the Code is subject to applicable regulatory statutes of the states and the United States. Comment 2 to section 7-103 makes it clear that such regulatory laws are not affected by the Code and remain paramount. In addition, section 10-104(1) provides:

The Article on Documents of Title (Article 7) does not repeal or modify any laws prescribing the form or contents of documents of title or the services or facilities to be afforded by bailees, or otherwise regulating bailees’ businesses in respect not specifically dealt with herein; but the fact that such laws are violated does not affect the

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*note 2.* who points out that the claim that a paper is not a warehouse receipt may be based on (1) legal defects in the character of the issuer, (2) factual defects in the character of the issuer (e.g., that the issuer was not a warehouseman), (3) defects in the receipt itself. This discussion is limited to the third category of irregularity.

*16* 324 F. 2d 830 (7th Cir. 1963).

*15* 324 F. 2d 830 (7th Cir. 1956); ILL. REV. STAT. ch. 114, §§ 293-326 (1967).
status of a document of title which otherwise complies with the
definition of a document of title (Section 1-201).

The definition referred to is section 1-201(15) which defines document
of title to include a warehouse receipt "... which in the regular course
of business or financing is treated as adequately evidencing that the
person in possession of it is entitled to receive, hold and dispose of the
document and the goods it covers."

The effect of section 10-104(1) seems to "legalize" otherwise
nonconforming receipts, nonconformity thereupon being deemed "... not [to] affect the status ..." of the receipt. Does "status" mean
standing as a valid receipt among any interested parties or only as
between the issuer and the holder as specified in section 7-103? There is
no satisfactory answer to this question.18

Insofar as state and federal regulatory laws may govern issuance
and form of warehouse receipts, and inasmuch as regularity of form
and issuance may well affect the rights of a holder, inquiry as to the
validity of receipts held by a pledgee cannot stop with the Code.19 One
example of the necessary examination of state law beyond the Code is
Illinois:

No warehouseman shall issue warehouse receipts to himself or co-
mingle grain owned by him with grain stored for others unless the
license issued to him by the Department so permits.20

It is fairly certain, despite the Code, that this provision would be
given its literal effect and that a pledgee of a warehouseman not in
compliance with Illinois law would receive nothing. This may not be
unreasonable if all are presumed to know the law since the frustrated
pledgee had constructive knowledge of irregularity and should not be
deemed worthy of sharing the remains with other more innocent
parties.

18. Professor Boshkoff reaches a similar conclusion. See Boshkoff, supra note 2, at 1375-
1377. He believes the UCC did not change state law in this respect and that continued
coeexistence of specialized state laws was contemplated.

19. Boshkoff, supra note 2; Boshkoff, Documents of Title: A Comparison of the Uniform
Rev. 711 (1961); Strohn, Article 7—Documents of Title, 30 Mo. L. Rev. 300, 319 n. 109
(1965); Trousdale, The Uniform Commercial Code: Article 7—Warehouse Receipts and Bills of
Lading, 50 Minn. L. Rev. 463 (1966).

B. The United States Warehouse Act\textsuperscript{21}

The only federal law which merits consideration is the United States Warehouse Act. This Act has no substantive effect on matters considered here, although compliance with the Act should be verified by a pledgee in view of the regularity and lawfulness of issuance of receipts. Section 255 of the Act provides that persons depositing products for storage in a warehouse licensed under the Act are deemed to have deposited them subject to the terms of the Act as well as the rules and regulations prescribed by the Secretary of Agriculture. The Act does not seem by this declaration to pre-empt state law or the Code in any manner. Section 260 which provides for the form and content of receipts issued by warehouses licensed under the Act will have some effect on the issue of regularity and lawfulness. However, Section 260 is essentially the same as section 7-202 of the Code, particularly with respect to the contents of receipts issued by a warehouseman for his own goods. The form of a federal receipt is standardized by regulation so deviation from the Code is easily noticeable.

It is arguable that federal regulation of warehouse receipts has preempted the field. Therefore, in the absence of substantive provisions in the Act governing such matters as overissue, the common law will prevail. However, this is contrary to general principles of federal pre-emption since there is no intent inherent in the federal Act to pre-empt the Code or state law on matters of substance except those expressly covered in the Act.\textsuperscript{22} For example, in Rice v. Santa Fe Elevator Corporation,\textsuperscript{23} the question was whether the United States Warehouse Act had superseded the authority of the Illinois Commerce


\textsuperscript{22} As to pre-emption, compare the pre-emption imposed by the Federal Bills of Lading Act (Pomerene Act) 49 U.S.C. §§ 81-124; Carmack Amendment to the Interstate Commerce Act, 49 U.S.C. §§ 20 (1964). Both are discussed in 2 Williston § 406a.

\textsuperscript{23} 331 U.S. 218 (1946). There is a suggestion in this case that if state law in any way restricts or qualifies the warehouseman's ability to issue receipts, state law is pre-empted and inapplicable. The context in which this suggestion is made makes clear that one reason pre-emption was thought necessary was to endow receipts of the federal licensees with full value for collateral purposes. Id. at 233 n. 11.

The Illinois Department of Agriculture takes the position that Illinois law should be observed by federally licensed warehouses. E.g., "I would take the position that, regardless of a federal license, where an Illinois license does not allow commingling of grain owned by the warehouseman, the grain of an outside customer should have preference over the grain stored by the warehouseman in his own behalf." Letter from Maurice W. Coburn, technical advisor, State of Illinois, Department of Agriculture, to the author, June 3, 1969.
Commission to regulate storage rates, issuance of securities, abandonment of service, operating without a state license and mixing grain with grains of different grades. All were accomplished by the movant-warehouse in violation of Illinois law. The warehouse company sought to enjoin further proceedings by the Illinois Commerce Commission for redress of practices contrary to Illinois law. Considering the dichotomy of federal and state regulations, the court reviewed the history of the United States Warehouse Act noticing that as originally enacted in 1916, the Act was subservient to state regulation. However, the court noted that by the 1931 amendment to the Act, Congress made the Act independent of state legislation. Based on the legislative history, the court held that the test in finding pre-emption on any matter is "... whether the matter on which the State asserts the right to act is any way regulated by the Federal Act."\(^24\) The court declared that where the Act contained no provision expressly relating to matters of state interest, state action was not foreclosed.

One confusing aspect of this holding is that federally licensed warehouses need not procure state licenses. If a state licensing law, such as that of Illinois, prohibits issuance of receipts for the warehouseman's own commingled grain without permission, it is arguable that state interest has not been foreclosed but that the interest cannot be observed because of its means of expression, that is, through state licensing.

Reference is also made to section 7-103 of the Code providing that the provisions of the Code are subject to statutes of the United States to the extent that such statutes are applicable. Conversely, if a federal statute is inapplicable, the Code will apply.

Section 268 of the Act provides that the Secretary of Agriculture may make rules and regulations necessary for efficient execution of its provisions. The question which might arise is whether rules and regulations promulgated by the Secretary would interfere, conflict with or supersede substantive provisions of the Code previously discussed? This is doubtful because the regulatory power of the Secretary is limited by the statutory delegation of authority. The statutory delegation of Section 268 would not include authority to promulgate rules and regulations affecting substantive rights beyond those expressly regulated by the Act.\(^25\)

\(^{24}\) 331 U.S. 218, 236 (1946).

\(^{25}\) See generally K. DAVIS, ADMINISTRATIVE LAW §§ 5.03 at 299, 5.04 at 308 (1958).
The commercial lender should consider, when choosing warehouseman customers, that since the enactment of the United States Warehouse Act, there has been no instance where any depositor loss was suffered as the result of failure of a federally licensed warehouse. Although there have been shortages upon failure of federally licensed warehouses, existing supplies and bond proceeds have been sufficient to pay liabilities of the federally licensed warehouse to depositors. The fact that 85 to 90 per cent of public grain storage in the United States is in federally licensed facilities or operated under agreement with the Commodity Credit Corporation probably accounts for the dearth of litigation concerning warehouse receipts.

The commercial lender should also note two specific aspects of federal licensing: the benefits of registration of receipts under the Act and the constant surveillance imposed upon licensees by the Act. By arrangement, the Administrator of the Agricultural Marketing Service branch of the Department of Agriculture may appoint a registrar of receipts for licensed elevators operating in any "terminal market." The appointment is not mandatory. Upon election to use the registrar, all receipt forms of an elevator are overprinted "Not valid until registered by U.S. Registrar." Changes in ownership are to be reported to the Registrar. The Registrar has supervisory duties, many of which would provide the same types of assurance and protection as a true field warehousing program.

C. Relative Rights in the Event of Overissue


This section considers the relative rights of holders of warehouse receipts, both depositors and pledgees, when it becomes apparent that there are insufficient goods in the warehouse to cover outstanding receipts due to the warehouseman's insolvency. Although the Code purports to codify and simplify previous law, the following discussion
indicates that scant attention was given by the draftsmen to the rights of a pledgee in the event of overissue.

Overissue occurs in various ways. If a warehouseman is dishonest, there is danger in taking his own receipt for goods which he represents he owns: Furthermore, the defalcating warehouseman, if he is also in the business of selling goods, can sell these articles covered by outstanding receipts thereby eliminating the rights of the holders of the receipts under section 7-205.

Overissue also may occur in more sophisticated dress. There is a general rule that when there is an overall shortage in the mass in a warehouse, the warehouseman's goods are appropriated by operation of law to the extent necessary to make up the deficiency of other depositors.31 Under this "appropriation doctrine," a shortage of goods under the warehouseman's own receipts may result although other depositors have no shortage.

Section 7-402 states the general Code rule respecting rights of parties in the event of a shortage of goods:

Neither a duplicate nor any other document of title purporting to cover goods already represented by an outstanding document of the same issuer confers any right in the goods, except as provided in the case of bills in a set, overissue of documents for fungible goods and substitutes for lost, stolen or destroyed documents. But the issuer is liable for damages caused by his overissue or failure to identify a duplicate document as such by conspicuous notation on its face.

Under this section, where two or more documents are issued covering the same goods, the first to become outstanding is the original and all others are duplicates. The holder of the original, or the first to become outstanding, is the person entitled to the goods. Other holders are relegated to an action for damages against the warehouseman.32

However, this section recognizes an express exception to the general rule in the case of fungible goods. Rights of certain holders in the event of overissue with respect to fungible goods are extended by section 7-207(2):

Fungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner.

31. See text accompanying notes 50-57, infra.
32. I W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UCC § 1.7001 (1964) [hereinafter cited as HAWKLAND].
for that owner's share. Where because of overissue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom overissued receipts have been duly negotiated.

This creates a second and special class of persons entitled to share in the mass of fungible goods remaining in the event of overissue. The "persons entitled" include all persons to whom overissued receipts have been "duly negotiated." In the event of an overissue, it is necessary to consider both section 7-402 and section 7-207(2) to determine who can share. If there is an overissue and if the "persons entitled" cannot satisfy their claims from the remaining goods, they will turn to the warehouseman's bond. It is conceivable that the "persons entitled" will exhaust the warehouseman's bond. When this occurs, others who might have a claim will be relegated to the status of a general creditor.

In order to determine who can share, two classes of persons must be identified: first, those specified by section 7-402, and second, the special class created by section 7-207(2), those "... to whom over-issued receipts have been duly negotiated."

The first class is more easily determined. It consists simply of persons who would be entitled to the goods whether or not there was an overissue. This class will be comprised, under section 7-402, of those persons whose receipts actually represent deposits. Anyone else will be holding either a duplicate or other document of title purporting to cover goods already represented by an outstanding document and will be precluded under section 7-402.

The second and special class of "duly negotiable holders" created by section 7-207(2) may include persons who are entitled to share with actual depositors even though their receipts may not represent deposits. Under the Uniform Warehouse Receipts Act, if competing claimants can show that a particular receipt did not represent a deposit, the holder is precluded from sharing.33 This is still true with respect to duplicate non-negotiable receipts or other receipts "... purporting to cover goods already represented by an outstanding document..." under section 7-402. However, the holder of a negotiable receipt now has a preferred position and can share with the actual depositors if he fits within the class of "duly negotiable holders" specified by section 7-207.34 The comment to section 7-207 states:

34. HAWKLAND § 1.700402.
Where individual ownership interests are merged into claims on a common fund, as is necessarily the case with fungible goods, there is no policy reason for discriminating between successive purchasers of similar claims.

The Code seems to say that if a pledgee bank can fit within the case designated by section 7-207, the bank should be allowed to share pro rata with persons who have actually made deposits.

This may be fair in principle, but it is questioned whether the Code intends this result if the warehouseman never had goods in the warehouse and had simply issued fraudulent receipts. It appears that the Code does not compel actual depositors to share with the bank in such case because there were never any goods to which the bank's lien could attach. However, suppose the warehouseman had sufficient goods on hand at the time of issuance to the pledgee bank but subsequently sells his goods or creates shortages in the goods of other depositors. The status of the pledgee bank versus that of the depositors in such an instance is not clear under the Code.

2. What The Code Purports To Do

The case which section 7-207(2) purports to overrule is Curacao Trading Company v. Federal Insurance Company. That case actually held that the holder of spurious warehouse receipts had no claim under an insurance policy which protected the holder of the receipts against nondelivery by virtue of fire and similar events.

More nearly applicable to the question involved is In re Harbor Stores Corporation which arose out of the bankruptcy which generated Curacao Trading. The bankrupt warehouse had stored cocoa beans and issued more receipts than there were beans on hand to cover. Twenty-four claims for the remaining beans were filed. The referee allowed nineteen on a pro rata basis. An unsuccessful claimant who was the holder of negotiable receipts appealed. At the time the receipts had been issued to this party, there were no beans in the warehouse to cover. All existing beans were owned by other depositors. The court affirmed disallowance of the claim on the basis that the claimant's receipt was a mere duplicate and a complete nullity.

35. 137 F.2d 911 (2d Cir. 1943), cert. denied, 321 U.S. 765 (1944); Braucher at 96-97; Hawkland § 1.700402.
37. It may be questionable whether this case dealt with fungibles at all as the court says:
Inasmuch as the claimant in *In re Harbor Stores* was a pledgee and the holder of negotiable receipts, the case seems to present facts which would be affected by section 7-207(2). However, the court did not appear to think that fungibles were involved. Assuming that fungibles were involved, and assuming that the Code does aim to affect a situation such as this, the intent of the Code as seen by the commentators is to allow the claimant in the *In re Harbor Stores* situation to share pro rata. The following discussion questions whether the courts will enforce such a result.\(^3\)

To determine which holders qualify as "... holders to whom over-issued receipts have been duly negotiated..." under section 7-207(2), it is necessary to define "holders" and "duly negotiated." If a pledgee bank cannot be both a "holder" and one to whom over-issued receipts have been "duly negotiated," it cannot be among this special class.

"Holder" is defined in section 1-201(20) as "... a person who is in possession of a document of title or an instrument or an investment security drawn, issued or endorsed to him or to his order or to bearer or in blank." A bank clearly can fit within this class.

Perhaps there is more difficulty under the second restriction which is one of "due negotiation." The question is whether taking a receipt from the warehouseman as pledgee is equivalent to negotiation. *Section 7-501* prescribes the requirement of "due negotiation":

1. A negotiable document of title running to the order of a named person is negotiated by his endorsement and delivery. After his endorsement in blank or to bearer any person can negotiate it by delivery alone.
2. (a) A negotiable document of title is also negotiated by delivery alone when by its original terms it runs to bearer.
   (b) When a document running to the order of a named person is delivered to him the effect is the same as if the document had been negotiated . . . .
3. A negotiable document of title is "duly negotiated" when it is negotiated in the manner stated in this section to a holder who purchases it in good faith without notice of any defense against or

\(^3\) The cases involving fungibles have no application, as there was no commingling here of the bags of the different claimants. Neither is there any basis for an estoppel against the real owner of the property." *Id* at 751.

\(^{38}\) If fungibles were not involved in *In re Harbor Stores*, then fungibles were not involved in *Curacao Trading* because the same bags of cocoa should have maintained their legal character. The commentators may have picked on an inept example for the Code to overrule unless the bags were assumed to be fungible for purposes of illustration.
claim to it on the part of any person and for value unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a money obligation.

Under section 7-501, a pledgee bank takes by due negotiation if it purchases the document in good faith for value in the regular course of financing without notice of any defense against or claim to the document on the part of any other person. There is no question that a pledgee is a "purchaser" as that term is defined in sections 1-201(32) and 1-201(33). The language of subsection 4 of section 7-501 and comment 1 to section 7-501 clearly contemplates the concept of due negotiation being operative in the case of a pledgee or other transferee "in the regular course of business or financing". A pledgee also can easily meet the requirements of taking in good faith, without notice of any defense or claim and for value.  

3. **Defeat of The "Duly Negotiated Holders"

   a. **General principles.** Even if a pledgee bank is among the special class of holders "... to whom overissued receipts have been duly negotiated ..." under section 7-207(2), its rights are subject to curtailment under instances specified in section 7-502. That section, in specifying the rights in the goods acquired by due negotiation, recognizes that even the otherwise preferred position of the "duly negotiated holder" may be upset under the exceptions imposed by sections 7-205 and 7-503:

   1. Where there has been a sale of the goods in the ordinary course of business by a warehouseman who is also in the business of buying and selling.  
   2. Where the bailment generating the document was unauthorized (as where a thief takes and stores goods and negotiates the document received).  
   3. Where the document is issued by a forger.  
   4. Where there are no goods existing upon which to issue a receipt. 

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39. See Braucher 53-60; 1 Hawkland § 1.6903, at 349-53.  
40. U.C.C. § 7-205.  
41. U.C.C. § 7-503(1)(a). No chain of title deriving from dealing with goods can prevail over title based on a negotiable document which is validly issued, but invalidity of issue is fatal to a claim based on the document. 1 G. Gilmore, Security Interests in Personal Property § 24.1 1965 (hereinafter cited as Gilmore); 1 Hawkland § 1.6903, at 354.  
42. Braucher at 61; 2 Williston § 443.
These exceptions seem logical enough initially. However, the exception indicated in paragraph 2 may give rise to some difficulty if the distinction between stolen goods and stolen documents is not recognized. If goods are stolen, deposited in a warehouse in exchange for a negotiable receipt and the receipt negotiated, there is an unauthorized bailment and the document confers no title. On the other hand, if the document itself is stolen and negotiated, the duly negotiated holder is accorded full rights. This distinction, as well as the above exceptions, is aligned with the general Code purpose of providing greater facility and reliability to the use of negotiable paper.

Yet the Code also recognizes that the concept of negotiability and the underlying title to goods conferred, although entitled to great consideration, cannot prevail to grant title when there was never any title to grant. The maximum protection that the Code gives the "duly negotiated holder" extends only to making the holder's claim not subject to defeat by stoppage, surrender of the goods by the bailee, negotiation in breach of duty, negotiation of a lost or stolen document and previous sale of the document or goods to a third person without delivery or other than in the ordinary course of business. It is incorrect, therefore, to say that in all cases the "duly negotiated holder" shares in goods on hand. It is clearly competent under the Code to show, in defeat of the duly negotiated holder's claim, any of these exceptions.

b. The anomaly of nonexistent goods. The most difficult exception and that which apparently conflicts with the express rights granted duly negotiated holders under section 7-207, is the fourth noted above. All commentators seem to assume that "... even due negotiation cannot create a bailee or goods where none exist ...." But insofar as section 7-207 seems to allow persons to whom receipts have been duly negotiated to share pro rata even if such persons did not make any deposits, there seems to be a serious anomaly in the Code.

As stated above, the Code seeks to overrule Curacao Trading. Assuming that the commentators have chosen that case as an example

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43 Bralcher at 61; 2 Williston § 417.
45 U.C.C. §§ 7-205, 7-502(2); 2 Gilmore § 25.4; 2 Williston § 427.
46 Bralcher at 61.
of the rights the Code would realign, it is clear that, contrary to exception four above, the Code allows a warehouseman to create rights in a pledgee who otherwise qualifies as a “duly negotiated holder” even though the warehouseman had no goods at the time of pledge.

Assume that a warehouseman pledges receipts for his own goods. Further assume that at the time he makes a pledge, he had no goods of his own to cover pledged receipts. If the warehouseman’s receipts are duly negotiated, is the holder allowed to share pro rata under Section 7-207(2) or is this receipt a nullity under the exception above because there were no goods to support the receipt? If the pledgee is allowed to share pro rata, the warehouseman, in effect, granted the pledgee rights in goods belonging to others. The warehouseman is little better than a thief. A thief cannot, through unauthorized bailment, create any rights in the “duly negotiated holder” by procuring a negotiable receipt. Under prior law, no interest was conferred in a pledge by a warehouseman who had no goods at the time of pledge.47 A contrary result would be ridiculous but if the Code actually seeks to overrule Curacao Trading, the result is dictated.

c. The doctrine of appropriation. The problem becomes more complex. Assume that the warehouseman pledges receipts for his own goods. Further assume that at the time the warehouseman makes the pledge, he had no goods of his own but later acquired some to “feed” the receipt. If no other depositor had any shortage, the pledge is valid under Section 7-502(1)(c).48

Now assume that at the time the warehouseman makes the pledge, he had goods of his own but in a minuscule amount and wholly insufficient to cover his outstanding receipts. Here, the duly negotiated holder can state that even if he takes no rights where there are no goods, there are currently goods on hand and he should, therefore, share pro rata. This instance seems to present the same problems as where there is a complete absence of goods.

Now assume that at the time the warehouseman makes the pledge, he had goods of his own but there was a shortage as to other depositors in the warehouse. Or, alternatively, assume that the shortage occurred subsequent to the pledge. Here the doctrine of appropriation for the benefit of other depositors must be met. The Code does not deal with this problem.49

47. 56 Am. Jur. Warehouse §§ 79, 167 (1947), and cases cited therein.
49. See Braucher at 101.
There is a general rule that if there is a shortage and the warehouseman has goods of his own in the warehouse, or adds goods of his own, the warehouseman's own goods are appropriated for the benefit of other depositors to the extent necessary to make them whole.\(^5^0\) Professor Braucher believes that if the doctrine of appropriation is applied to the prejudice of the warehouseman's creditors an unfair result is achieved.\(^5^1\) However, where the rights of actual depositors, who may be small farmers, are asserted against the rights of a bank financing a dishonest warehouseman, it is likely that the farmers will win.\(^5^2\) This is so particularly since the Code does not provide otherwise and the doctrine of appropriation is generally accepted.\(^5^3\) The rule of appropriation announced in *Hall v. Pillsbury*,\(^5^4\) considered the leading case, is:

But, while the interest of the depositor in the mass is measured by what he deposits..., the interest of the warehouseman, by reason of putting his own grain in the mass, is not necessarily measured by what he puts in; for if, from any cause for which he is responsible, as by his taking grain out from [sic] the mass, the whole amount is diminished below what is required to fill the outstanding receipts, what he puts in is appropriated at once, so far as may be necessary, to the receipts, and becomes at once the property of the holders.

The seriousness of the appropriation doctrine is seen when the courts view the proceeds of the warehouseman's bond as the substitute for goods when a shortage is discovered. Depositors, consequently, may have the right not only to exhaust the remaining goods, but also to appropriate bond proceeds in satisfaction of their receipts prior to the hapless bank-pledgee asserting his claims. In such event, the holder of a receipt which never represented any goods or from which the underlying goods were appropriated might be considered a junior lienor who has a secured position secondary only to that of the holders of receipts which represented goods when issued. This is fair

\(^{50}\) 56 AM Jur. Warehouse § 168 (1947).

\(^{51}\) Braucher at 101.

\(^{52}\) See infra pp. 30-35 for cases which seem to favor the innocent third party.


\(^{54}\) 43 Minn 33, 36, 44 N.W. 673, 674 (1890).
and gives such a holder priority in sharing any remainder of goods, bond proceeds or other assets of the insolvent warehouse. This analogy has been made.\textsuperscript{55} Assuming the goods are gone, satisfaction comes primarily from bond proceeds, but only after other depositors are paid leaving him in the position of an unsecured creditor claiming out of the general assets of the insolvent warehouseman's estate.\textsuperscript{56} If such a junior lienor can trace the proceeds of his loan, he might be able to assert some form of equitable lien, but such tracing is difficult of proof.\textsuperscript{57}

d. \textit{Discerning a result by extrapolation—prior case law.} Only one case seems to support the theory of sharing which the Code appears to promote. It is doubtful whether that case was well considered or is applicable since the issue was not directly considered. Several other cases, none of which were decided under the Code, seem to reach a result opposite from the Code upon a better reasoning.

\textit{McDonnell v. Bank of China,}\textsuperscript{58} is the only case which seems to reach the Code result and Professor Braucher agrees that it is the right result.\textsuperscript{59} There, Trader deposited flour in Warehouse as collateral security for the payment of a loan from Warehouse to Trader. It is not clear whether Warehouse issued Trader receipts and took a pledge, or whether the goods were held as a pledge. Warehouse, in turn, discounted Trader's note to Bank and issued a receipt to Bank which stated "we have received the goods mentioned in this instrument and will hold them to (your order)." Upon the subsequent insolvency of both Trader and Warehouse, it was discovered that there were insufficient goods to cover outstanding receipts, including those held by Bank. Bank sought to assert its pro rata interest in the remaining goods. The other claimants argued that no rights were conferred upon Bank. The court held that Bank was entitled to share on an equal footing, stating:

As long as the Warehouse Company held the note of the Trading

\textsuperscript{55} Merchants Nat'l Bank v. Roxbury Distilling Co., 196 F. 76, 96, 102 (D. Md. 1912).
\textsuperscript{56} 4A W. Collier, Bankruptcy \S 70.18(6) (14th ed. 1968).
\textsuperscript{57} 4A W. Collier, Bankruptcy \S 70.25(2) (14th ed. 1968). Difficulties in such tracing are exemplified by the case of Central States Corp., v. Luther, 215 F.2d 38 (10th Cir. 1954), \textit{cert. denied}, 348 U.S. 951 (1955).
\textsuperscript{58} 33 F.2d 816 (9th Cir. 1929), \textit{cert. denied}, 280 U.S. 612 (1930).
\textsuperscript{59} Braucher at 100.
Corporation, it will be conceded that it (the Warehouse Company) could assert no right as pledgee in any of the flour in storage as against the holders of warehouse receipts, where there was not sufficient flour in storage to meet the demands of all.

But when the Warehouse Company attorned or transferred its right in the pledged property to the appellant, a different situation arose. For while prior to the transfer the Warehouse Company held the pledged property in its own right, after the transfer it held as agent or bailee for the transfer it held as agent or bailee for the transferee. It may be conceded that the relations existing between the Warehouse Company and the holders of outstanding warehouse receipts were somewhat different from the relation existing between the Warehouse Company and the appellant, but in the absence of some statute giving a priority of right to the holders of warehouse receipts, we are of the opinion that the several claimants stand on an equal footing in a court of equity. 60

Analyzing this case, it is possible to say that the flour in question which had been pledged to the bank was, in effect, owned by Warehouse. This is because Trader also was insolvent and whatever rights Trader had in the flour accrued to Warehouse as Trader’s pledge. If Warehouse owned the flour, it may seem that under the appropriation doctrine, Warehouse’s flour would be applied to shortage of other depositors in derogation of the Bank’s rights. However, this was not done, and Professor Braucher argues that this is the correct result under the Code, assuming Bank took a negotiable receipt. Professor Braucher further points out that if Bank did not take a negotiable receipt, it could have only the right Warehouse had under section 7-402. 61

The McDonnell case has never been cited. It was criticized on the basis that if there was not enough flour to cover at the time of the pledge from Warehouse to Bank, the Bank should not be able to take as a tenant in common because of the rule in Hall v. Pillsbury. The critic further remarks that the court ignored the necessity of proof by the Bank that there was any flour sufficient to cover at the time of the pledge by Warehouse to Bank. According to many authorities, including Professor Braucher, the Code seeks to overrule the Curacao

60 33 F. 2d 816, 819 (9th Cir. 1929) (citations omitted).
61 Braucher at 100.
62 Note, 39 Yale L.J. 432 (1930).
Trading case. Again, it seems that despite the authorities stating that no rights can be created in a pledgee where no goods exist, the intent of the Code rejects that position.

4. Speculation—How Will the Courts Treat the Code?

Several more recent cases reach a result contrary to that of the McDonnell case and more in line with that of Curacao Trading. None of these were decided under the Code but they are mentioned here as an indication of prior authorities the Code will have to overcome if the curious result dictated by its plain language will pertain.

In Central States Corporation v. Luther, a claimant sought judgment against the trustee in bankruptcy of an insolvent warehouseman for the possession of grains and funds in possession of the trustee. Prior to bankruptcy, claimant had purchased and paid for milo which was supposed to be owned by the bankrupt warehouseman. As evidence of the purchases, claimant received the warehouseman’s receipts for the milo. Each receipt was designated as negotiable and contained a statement that the bankrupt had received a specified number of bushels of milo “in store” for the claimant. Noting Kansas statutory requirements for receipts issued by a warehouseman, particularly a provision that receipts of a warehouseman were unlawful unless grain had been deposited and under the warehouseman’s control, the court found that issuance and delivery of the receipts held by claimant did not conform to the statute. Since these receipts were not validly issued, claimant was not permitted to use his receipts as a basis for an assertion of any right to grain in the warehouse upon the bankrupt’s insolvency.

Prior to the warehouseman’s insolvency, claimant asked for and received from the warehouseman several deliveries of the milo claimant purchased. The trustee in bankruptcy sought reclamation of the milo arguing that the deliveries were a preference. Claimant argued that he was able to trace his money to the commingled fund of milo which came into the trustee’s hands and that an equitable lien or

64. This points up the necessity for strict compliance with state law as to form and regularity in issuance of receipts.
constructive trust upon the milo had been established. This, he urged, should entitle him to enforce his warehouse receipts pro rata by retaining the milo which had been delivered to him prior to the bankruptcy. Not only did the court deny claimant a pro rata share of milo, but the court also forced claimant to return all of the milo. The court stated:

It is the well established rule of law in Kansas and elsewhere that where owners of grain deposit it with a warehouseman for storage . . . the relationship among the several depositors is that of tenants in common of the commingled mass . . . and the right of the warehouseman to sell or make other disposition from a common mass is limited to the excess thereof over and above the quantity necessary to redeem the receipt for other commitments issued to the depositors . . . The referee found as a fact that the bankrupt delivered to the claimant milo in the amount of 876,191 pounds when it did not have in the common mass any excess over and above the amount required to discharge his obligations to the depositors of milo. Therefore, the delivery to the claimant of that grain amounted to a transfer from the common mass which did not belong to the bankrupt but to the depositors thereof as tenants in common.65

The result is much like the holding of Hall v. Pillsbury. Although the court made the above statement in the context of avoiding a sale from the bankrupt warehouseman to the claimant, it seems that the same reasoning governs a pledge and relegates a pledgee to a junior position where the warehouseman does not have sufficient goods of his own on hand to cover at the time of pledge.

Gould v. City Bank & Trust Company66 involved priorities between holders of negotiable receipts. Issuer’s negotiable receipt for whiskey was pledged for a loan. When the loan was paid, the receipt was not returned. Subsequently, issuer procured another loan pledging other negotiable receipts respecting the same goods. In turn, the first pledgee transferred the receipts which were never returned when the first loan was paid. The holder of the receipts which were first issued was determined to have full right in the goods while the subsequently issued receipts conferred no rights. The court stated:

66  213 F 2d 314 (4th Cir. 1954).
That warehouse receipts first issued and outstanding since date of issuance have priority of right over those subsequently issued on the same property is, of course, well settled.67

There is no dispute that this is the correct rule under section 7-402 if the underlying goods are not fungible. The court does not consider whether or not the whiskey was fungible. It cites, as authority for its holding, Curacao Trading and Merchants National Bank of Baltimore v. Roxbury Distilling Company,68 where the court apparently treated whiskey as a fungible. It was previously remarked that the court in In re Harbor Stores Corporation, which arose from the same bankruptcy as Curacao Trading, considered the bags of cocoa beans nonfungible. In view of this confusion, the import of Gould v. City Bank & Trust is questioned.

In United States v. Merchants Mutual Bonding Company,69 Benson-Quinn purchased soybeans from a Warehouse, Upon Warehouse’s insolvency, there were not enough goods to cover outstanding receipts. The goods on hand and the proceeds of the bond together were insufficient to satisfy all of the claims. Some claimants contested the allowance of Benson-Quinn’s claim on the grounds that there was a shortage of goods at the time of Benson-Quinn’s purchase. Therefore, since the rights of other innocent parties were involved, Benson-Quinn should not have been able to assert any claim until all other claimants were satisfied. The court held for Benson-Quinn, allowing them to share. The court distinguished the first Luther case on three grounds: (1) that claimant there held invalid receipts; (2) that claimant there knew there was no milo in the warehouse when it received deliveries; and (3) that claimant there was unable to trace his money to grain in the warehouse. The court also distinguished the Central National Bank of Mattoon case on the ground that in that situation it definitely could be said that there was no grain in the warehouse at the time receipts were issued to the claimant. In view of the distinctions made in Merchants Mutual Bonding Company, some support may be found for the Code rule, at least where competing claimants cannot show a complete absence of grain owned by the warehouseman.

In Merchants Mutual Bonding Company, the argument that where the rights of other innocent parties are involved, the claim of the

67. Id. at 316.
68. See text accompanying note 87 infra.
holder of the warehouseman's own receipt should not share was refused. However, favoring the rights of innocent parties was prominent in at least one decision. In *Fidelity State Bank v. Central Security and Insurance Corporation*, a surety company sought to avoid liability on its bond on the grounds that warehouse receipts taken by a bank as security and purporting to cover goods owned by the warehouseman did not comply with state law. In denying recovery to the bank, the court stated:

If transactions like those in this case are upheld, the holders of invalid receipts may make a claim against the bondsman of the warehouseman, and the protection sought to be given those who store grain in warehouses or who purchase valid warehouse receipts, could be destroyed.

Finally, *United States v. Haddix & Sons, Incorporated* must be considered. It is an instructive decision touching closely upon, if not fully disposing of, the present speculation. This case was the "...third installment in another story of a warehouseman who could not resist the temptation to sell what he should have been storing." The competing claimants were Commodity Credit Corporation (CCC) and the National Bank of Detroit (Bank).

CCC stored corn in the Haddix warehouse. Haddix did not have sufficient supplies to meet outstanding receipts, most of which were held by CCC. Neither CCC nor the Bank was aware of this. Haddix found itself in a position where it could make sales to Ralston-Purina at $1.23 ½ per bushel. At the time, the price Haddix paid CCC for the corn was almost $1.16 per bushel. Haddix could turn a quick profit if it raised the money to purchase from CCC. Haddix approached the Bank, which had no more reason than CCC to know of Haddix' condition, for a loan. It was arranged that the Bank would loan to Haddix on a demand basis, the loan to be secured by a chattel mortgage on the corn. In effect, it was a purchase money mortgage. The deal was consummated and the proceeds of the loan used to pay CCC.

Eventually, the fact of Haddix' insolvency and shortages came to

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70. 228 F. 2d 654 (10th Cir. 1955). See also *Maryland Casualty Co. v. Washington Loan & Banking Co.* 161 Ga. 354, 145 S.E. 761 (1928) (dictum indicating that the warehouseman's pledge should not, perhaps, be upheld where innocent parties are involved).
71. 228 F. 2d at 657.
73. *Id* at 827.
light. Haddix was placed in receivership and the corn in storage was transferred to CCC by the receiver upon the government’s promise to indemnify persons later shown to have an interest in the mass. The Bank then asserted its rights under its security arrangement with Haddix.

The government’s position was simply that a shortage existed at the time of the purchase from CCC. Therefore, under the doctrine of appropriation, when Haddix purchased from CCC, CCC’s right immediately became choate and attached to the corn Haddix purchased thereby appropriating Haddix’ corn to make up the shortage and defeating the rights of the Bank under its chattel mortgage. The court said:

[The government’s position] . . . rests upon dicta in Pillsbury that a warehouseman who does not have sufficient produce on hand to meet his bailment obligations and adds his own to the mass immediately loses title to so much of the newly introduced amount as would be necessary to redeem outstanding receipts were they then submitted for satisfaction.\(^\text{74}\)

Nevertheless, the court awarded the Bank its share and sustained its chattel mortgage on the grounds that it was a purchase money chattel mortgage and, as such, under Michigan law and the law generally, was entitled to precedence under Michigan law and the general law.\(^\text{75}\) The court correctly justifies its result by reasoning that the purchase money mortgagee, although a mortgagee in the legal sense, is in many respects the true buyer for he: (1) supplies the money which causes the vendor to transfer title; (2) has more equity in the subject matter than the nominal buyer; and (3) relies primarily on the vendor’s title in extending credit.\(^\text{76}\)

Although it is unfair to read conclusions by negative implication into this case, particularly since it was a pre-Code case, it is fair to observe that had the Bank been other than a purchase money mortgagee or had it held other than a purchase money security interest, it might, under this analysis have been left remediless. This is particularly clear when one recognizes the thrust of the court’s statement that “Commodity is no better off than a non-purchase money mortgagee who relies on a standard after-acquired property clause.”\(^\text{77}\) If that was CCC’s actual position, it is clear that it would

\(^{74}\) Id. at 834.
\(^{75}\) This is also true under the Code if the procedures of section 9-312(3) are followed.
\(^{77}\) Id. at 836.
have had priority over the Bank if the Bank had not been a purchase money mortgagor. 78

In summary, the Code seems to reach a somewhat novel result by favoring holders to whom receipts for fungible goods have been duly negotiated. Possibly, the Code goes even further and grants this preferred class some rights in a remaining mass and in the proceeds of the warehouseman's bond. This is true even where there are never any goods to support issuance of the holder's receipts. 79 Code commentators agree that no right can be created where no goods exist. On the other hand, the commentators state that the Code seeks to change the rule of Curacao Trading and import the rule of McDonnell v. Bank of China. These two statements are wholly contradictory. This convolution aside, the Code completely ignores relative rights where the doctrine of appropriation is involved. Code commentators feel that the doctrine of appropriation should not operate to defeat creditors of the warehouseman. On the other hand, what prior law there is seems to favor actual depositors over such creditors.

Certainly, no harm devolves from a pledgee taking a negotiable receipt. Since there is at least a likelihood under the Code that a duly negotiated holder will gain a preferred position, the mere possibility is enough to dictate the prudent business man insisting upon negotiable receipts. 80 The conjectural additional protection given by such

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78 Since this case involved a national bank, it is appropriate to observe that the Federal Reserve Board considers chattel mortgages dissimilar to warehouse receipts locking title into the document and may consider all warehouse receipts issued by the warehouseman for his own goods ineligible for rediscount, see 1918 1 st Res. Bull. 309, 437, 871. Moreover, one might observe the problem of national bank lending limitations imposed by 12 U.S.C. § 84 (1964). The limitations may be excepted to under 12 U.S.C. § 84(6) (1964), if the loan is secured by warehouse receipts of the borrower but only where the receipts are registered with an independent registrar, 11 U.S.C. § 678.16(5). Had there been an independent registrar here, Haddix might have been kept under control and the day of reckoning avoided.

As a practical matter, the question of qualification for discount is not a problem as, with the exception of cotton in the Memphis Federal Reserve District, there considered a fungible, Federal Reserve Banks even in terminal markets rarely if ever discount loans secured by warehouse receipts. The existence of the warehouseman's own receipts as collateral in a member bank's portfolio, if otherwise satisfactory, will not be criticized by examiners. Interview with F. Garland Russell, Jr., Esq., legal department, Federal Reserve Bank of St. Louis, Missouri, September 17, 1968. See also, 1921 Fed. Res. Bull. 1314.

79 In the only case yet to mention Section 7-207, the Court in dictum complains that holders of duly negotiated receipts "... may obtain a proprietary interest in bailed fungibles of another even though the receipt was not originally issued for the deposit of actual oil ..." Proctor v. Gamble Distrib. Co. v. Lawrence American Field Warehousing Corp., 22 App. Div. 2d 420, 255 N.Y.S.2d 788 (1965).

80 This is a lawyer's statement. It should be recognized that business considerations could
negotiable receipts cannot equate adequate policing measures as an adjunct to reliance upon the warehouseman’s honesty.

D. Verification of Issuing Agent’s Authority

In the ordinary course of financing, a bank may take warehouse receipts without questioning the authority of the warehouseman’s agent to issue receipts. It is questioned whether this course of dealing is safe from the obvious standard attack by a familiar competing claimant. The feared trustee in bankruptcy or a bonding company might base a claim of invalidity of receipts on the lack of authority of the issuing agent.

Despite considerable confusion under the common law, the Pomerene Act and the Uniform Warehouse Receipts Act as originally promulgated, 81 the question of the issuer’s liability for his agent’s acts now seems fairly well settled by the Code. Section 7-203 provides in part:

A party to or purchaser for value in good faith of a document of title other than a bill of lading relying in either case upon the description therein if the goods may recover from the issuer damages caused by the non-receipt or misdescription of the goods . . . .

(Emphasis supplied.)

Section 7-102(1)(g) defines “issuer” so as to remove any doubt with respect to the principal’s responsibility:

‘Issuer’ means a bailee who issues a document . . . . Issuer includes any person for whom an agent or employee purports to act in issuing a document if the agent or employee has real or apparent authority to issue documents, notwithstanding that the issuer received no goods or

81. Braucher at 22-23; 2 Williston §§ 419, 419(a), 419(c).
that the goods were misdescribed or that in any other respect the agent or employee violated his instructions.

Since sections 1-201(32) and 1-201(44) cause a pledgee bank to be a purchaser for value, it appears that the warehouseman is bound to the bank by any receipts which are delivered so long as the agent signing has at least apparent authority even if the agent has violated his instructions. However, it must be recognized that the Code provisions regarding the warehouseman's liability are directed more at the warehouseman's responsibility for causing damage to depositors through misdescription or for causing damage to purchasers of documents who rely on description or the existence of the goods. The provisions are less concerned with the benefit of the pledgee who seeks only confirmation that the warehouseman himself owns certain goods. The receipt issued by the warehouseman in such a case amounts to a pledge of the goods, particularly if it is issued in the name of the pledgee. There, the question is not simply whether the agent issuing the receipt has authority to sign the receipt. One must also ask whether the agent has authority to make a pledge or grant a security interest on behalf of his principal. The quantum of authority of the latter act to be valid is greater than that required simply to sign a receipt acknowledging that goods have been delivered for storage. Consequently, it seems necessary to have the borrowing resolution of the warehouseman specifically refer to and grant appropriate authority to designated individuals to execute and deliver receipts by way of pledge. If the pledge is good against the principal, it is also good against the trustee in bankruptcy.82

II. MAINTAINING AND PERFECTING SECURITY INTERESTS

Thus far, the focal point has been Article 7. The material has little relevance to financing arrangements other than those founded upon warehouse receipts. In order to explore all of the financing problems involved, it is essential to devote some attention to the influence of Article 9.

Article 9 is axiomatic in any secured transaction because it establishes a comprehensive set of rules governing the relationships of secured parties, debtors and other claimants with respect to every variety of security interest and collateral. Loosely designating the

82 4 H. REMINGTON, BANKRUPTCY § 1731 (1957).
giving of a warehouse receipt as security for a debt, it should be recognized that a "pledge," or a delivery of possession as security is regarded by the Code as simply another type of security interest. Since all security interests are brought under the roof of Article 9, consideration of this form of secured transaction necessarily involves consideration of all other forms of secured transactions. Consequently, the following discussion, which is set in the framework of a bank financing a warehouseman on his fungible inventory, will apply to relationships considerably broader than those considered in Part I. The problems of perfection and priority are not restricted to warehousemen, fungibles or inventory owned by the issuer of a document. The discussion of how the banker will perfect his security interest and maintain his secured position is equally applicable to documentary drafts and letters of credit. Any discussion of priorities involves review of the entire Code philosophy regarding competing claimants. Also, one cannot presume to answer the banker's questions about warehouse receipts without a firm grasp of the relative positions of purchase money mortgagees and accounts financers.

The banker's primary concern is that his security interest be perfected. There are a number of problems raised in determining which method of perfection should be used and how to insure continued perfection upon release of the collateral to the warehouseman for sale or shipment. More important is the realization that continuity of perfection is not achieved by a single act at the initiation of a financing arrangement. This fact necessitates the development of some pragmatic solutions to the following questions:

1. How is perfection of a security interest in documents, goods covered and the proceeds achieved?

2. How is perfection continued when goods or documents are released on trust receipt to the debtor for sale or shipment and what priorities does the Code establish among competing claimants to documents, proceeds and other forms assumed by the collateral?

Part II of this article is necessarily in the nature of a potpourri. A fortunate aspect is that the general principles involved which apply to the hypothetical case may be applied to different forms of secured transactions.

A. Perfection of Security Interests in Documents, Goods and Proceeds

Perfection is treated in Article 9 of the Code. While perfection with
respect to the type of collateral does not present any peculiar difficulties, it is necessary to understand the theory of the Code as applied to perfection in negotiable and non-negotiable documents, the goods covered and the proceeds. Understanding the theory aids in extrapolating Code rules of priority discussed in the succeeding section.

Warehouse receipts are classified as "documents" under the Code definitions in sections 9-105(1)(e) and 1-201(15). 83 The Code makes a basic distinction between negotiable and non-negotiable documents. The negotiable document embodies title to the goods, 84 so that possession of a negotiable document is the same as possession of the goods. 85 Conversely, there is no direct relationship under the Code between possession of a non-negotiable document and title to the goods it represents. Title to goods covered by a non-negotiable document is not embodied in the document. 86 As expected from these conceptual differences, perfection where negotiable and non-negotiable documents are involved is treated differently under the Code. There is

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83 "Document" means document of title as defined in the general definitions of Article I, section 1-201(15).

U.C.C. § 9-105(1)(e).

"Document of Title" includes ... warehouse receipt ... and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of ... the goods it covers. To be a document of title a document must purport to be issued by, or addressed to, a bailee and purport to cover goods in the bailee's possession which are neither identified or fungible portions of an identified mass.

U.C.C. § 1-201(15).

84 1 Gilmore § 24.1. A searching, historically analytical treatment of perfection is made in this treatise. A check-list of the basic differences between negotiable and non-negotiable documents. § 12.6, emphasizes differences alluded to above, and these distinctions are further analyzed at § 14.6.2.

85 During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

U.C.C. § 9-304 (3).

86 1 Gilmore § 12.7 at 389-90. For example, the warehouseman's obligation to deliver is different in the case of goods covered by negotiable and non-negotiable documents. Under section 7-403(4) the "person entitled" to goods is the holder of the document, if negotiable. In the case of a non-negotiable document, the "person entitled" is anyone to whom delivery is to be made by the terms of or pursuant to written instructions under a non-negotiable document. They key difference here is that possession or surrender of the non-negotiable document is not a prerequisite to delivery of goods. The person shown on the warehouseman's books as being the issuer of a non-negotiable document can control the goods unless as assignee has notified the warehouseman of his interest.
actually no Code provision for perfection of a security interest in non-negotiable documents. This is contrary to the theory that non-negotiable documents do not represent ownership per se of the underlying goods.87

A security interest in negotiable documents may be perfected by possession or filing as provided by sections 9-304(1) and 9-305.88 Recognizing that many transactions involving security interests in documents are relatively short-term, section 9-304(4) provides for perfection without filing or possession.89 This section contemplates short-term transactions where the secured party may, immediately upon receiving the collateral, release it to the debtor so the debtor may dispose of it and pay the secured party. However, perfection without filing or possession for such purposes and under such conditions must be preceded by (1) new value, and (2) a written security agreement. The security interest so acquired will not, of course, be good against good-faith purchasers and holders in due course should the debtor transfer the negotiable instrument or sell the goods to a third party.

Perfection for non-negotiable documents is governed by section 9-304(3). As the section illustrates, this is equivalent to perfection on the goods themselves.

A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of secured party, or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.90

As in the case of negotiable documents, perfection with respect to non-

87. 1 Gilmore § 12.7 at 389-90.
88. A security interest in chattel paper or negotiable documents may be perfected by filing. U.C.C. § 9-304(1). Filing, however, is an illusory method in view of the provision: Nothing in this Article limits the rights of . . . a holder to whom a negotiable document of title has been duly negotiated. . . . and such holders. . . . take priority over an earlier security interest even though perfected.
U.C.C. § 9-309.
A security interest in . . . goods, instruments, negotiable documents or chattel paper may be perfected by the secured party's taking possession of the collateral.
U.C.C. § 9-305.
89. A security interest in . . . negotiable documents is perfected without filing or taking of possession for a period of 21 days from the time it attaches to the extent it arises for new value given under a written security agreement.
U.C.C. § 9-304(4).
90. U.C.C. § 9-304(3).
negotiable documents, or the goods covered thereby, may be achieved without possession or filing, if the secured party gave the bailee notification of its interest in the goods.\textsuperscript{91} Since, under section 7-403(4), delivery of goods covered by a non-negotiable document can be made by the bailee without taking a non-negotiable document, the importance of either notifying the bailee or having the non-negotiable document issued in the name of the secured party is obvious. Only in these ways can the secured party holding a non-negotiable document be certain of control of the goods.

Comparing perfection, without filing or possession, of both negotiable and non-negotiable documents, Professor Gilmore observes that perfection on negotiable documents may: last for 21 days; or, in the case of goods held by a bailee who has not issued a negotiable document and who has notification, continue indefinitely; or, if filing is required by Article 9, be non-existent.\textsuperscript{92} The filing provisions of Article 9 require filing only in the case of goods covered by a non-negotiable document when the document is not issued in the name of the secured party or the secured party has not notified the bailee of its interest in the goods. Filing alone creates a dangerous situation, as a pledgee procuring a negotiable document from the owner of the goods will achieve higher priority than the secured creditor relying wholly on his filing as to the goods. Filing is an alternative method of perfection in the case of negotiable documents but is not required and is an illusory method of perfection since a later claimant claiming through due negotiation and possession of the negotiable document is, under section 9-309, prior in right even to earlier interests perfected by filing. It may be concluded that filing alone is not a satisfactory means of perfection. Without holding a negotiable document, having a non-negotiable document issued in the secured party’s name, or notifying the bailee, control over the goods and with it any real protection is lost for practical purposes.

B. Perfection of Security Interests in Proceeds of Documents and Goods Covered

There are two code provisions relating to the perfection and effect of a security interest in proceeds. Sections 9-306(2) and 9-306(3)

\textsuperscript{91} Id

\textsuperscript{92} Gilmore § 14.6.2 at 458. Filing alone creates a dangerous situation as a pledgee procuring a negotiable document from the owner of the goods will prime the secured creditor relying wholly upon his filing as to the goods.
cover perfection in proceeds in cases where the debtor is solvent. Section 9-306(4) provides special rules in the case of insolvency.

(1) . . .

(2) Except where this Article otherwise provides, a security interest in collateral continues notwithstanding sale, exchange or other disposition thereof by the debtor unless his action was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after the receipt of the proceeds by the debtor unless
(a) a filed financing statement covering the original collateral also covers proceeds; or
(b) the security interest in proceeds is perfected before the expiration of ten day period.

(4) In the event of insolvency proceedings instituted by or against the debtor, the secured party with a perfected security interest in proceeds has a perfected security interest
(a) in identifiable non-cash proceeds;
(b) in identifiable cash proceeds in the form of money which is not commingled with other money or deposited in a bank account prior to the insolvency proceedings;
(c) in identifiable cash proceeds in the form of checks and the like, which are not deposited in a bank account prior to the insolvency proceedings; and
(d) in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph (d) is
(i) subject to any right of set off; and
(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the ten day period.

It is readily apparent that the proceeds provisions will be completely irrelevant unless either the warehouseman sells in the ordinary course of business\(^93\) or the bank acquires in disposition of the

\(^93\) Under the Code, simply putting goods into a warehouse likely to contain the operator's
collateral. In any other case, the third party will take subject to the bank's security interest.

Regarding the proceeds provisions, if the security interest in the original collateral is perfected, the security interest continues in identifiable proceeds for a period of ten days following a sale by the debtor so long as those proceeds are "identifiable" within the Code. Caution is advised for homogenizing the twenty-one-day grace period applicable to continue a security interest in goods or documents released to the debtor with the ten-day grace period during which the security interest in proceeds continues. It can be seen that the actual grace period may be as short as ten or as long as thirty-one days. If a debtor disposes of documents or goods on the day they are released to him, the secured party has only ten days in which to impress his interest. If, on the other hand, the documents or goods released are not disposed of by the debtor for twenty-one days, the secured party still has another ten days to reach the proceeds.

Clearly the safest course to follow in a program of financing where warehouse receipts are redistributed to the debtor in express anticipation of liquidation of the collateral is to file at the outset on goods, documents and proceeds. If this is accomplished, the security interest in proceeds will continue so long as the proceeds are identifiable. There is then no worry about expiration of the ten, twenty-one or thirty-one day grace period. Filing excuses a bank from the strictest policing tactics but whether policing tactics should be relaxed is questionable because of the problem of attempting to trace proceeds as well as some following unanswerable questions of priority.

C Delivery of Documents Upon Trust Receipts and Priorities Among Claimants to the Goods and Proceeds

The practical lender wants to know, once he is assured of a perfected security interest, whether his interest may be impeached either by other creditors or by a trustee in bankruptcy. This requires exploration of the labyrinth of priorities among security interest under the Code.

1. General Principles

The Code's basic system of priorities is established in section 9-312.

\footnote{own goods is sufficient to clothe the operator with such indicia of ownership that buyers from him take free of adverse interests, U.C.C. § 7-205. See United States v. Haddix & Sons, Inc., 268 F. Supp. 825, 833-34 (E.D. Mich. 1967) (dictum).}
\footnote{94. U.C.C. §§ 2-403, 7-503(1).}
This section, however, is not all-inclusive but refers to other sections of the Code which deal with specific types of collateral that create unique problems. The category of documents, which includes warehouse receipts, is one of the specific types of collateral for which sections other than section 9-312 may determine priorities. The necessity of reference to priority rules other than the general rules of section 9-312 is largely due to some of the peculiar title transferring qualities of documents. This recognition of "special" qualities is what makes questions of priority in documents somewhat difficult.

The general priority rules of section 9-312(5) are simple enough and provide this priority:

(a) in the order of filing if both are perfected by filing. . .
(b) in the order of perfection unless both are perfected by filing. . . and, in the case of a filed security interest, whether it attached before or after filing. . .
(c) in the order of attachment . . . so long as neither is perfected.

The additional concepts injected by these rules are perfection and attachment. Perfection occurs when the secured party has taken whatever steps are necessary to give himself an interest in the collateral that cannot be defeated in insolvency proceedings.95 The steps necessary will be determined by the Code provision applicable to the type of collateral involved. Attachment of the security interest is not necessarily coterminous with perfection and occurs under section 9-204(1) when: (1) there is agreement that it attach; (2) value is given; and (3) the debtor has rights in the collateral. To determine exactly when this third requirement may be fulfilled is difficult when a sales situation is involved and may necessitate reference to Article 2 for a satisfactory resolution.96

The special inventory purchase money priority created by section 9-312(3), in substance, is that the purchase money interest is always prior if (1) it is perfected at the time the debtor receives possession of the collateral and (2) if other secured parties known to the purchase money man, or previously filed on the same types of inventory, have received notification of the purchase money interest prior to the debtor receiving possession of the collateral.

The sections outside section 9-312 which are relevant to priorities in

95. U.C.C. § 9-301, comment 1.
documents and goods covered by documents are sections 9-304 and 9-309. Section 9-304 states the basic methods for perfection on documents and goods. It contains the rules of permissive filing, perfection without filing and perfection without possession or filing for twenty-one days. It is not a priority section and is useful in determining when perfection occurs where the first-to-perfect rule is operative. Section 9-309 creates vastly superior rights in negotiable documents by providing that holders and persons taking by due negotiation take priority over earlier security interests even if perfected.

Within this framework, several areas should be noted in which confusion may develop. The first-to-file rule is simple to apply where both interests are perfected by filing. Likewise, the first-to-perfect rule is not particularly difficult where neither competing interest was perfected by filing. However, when one interest is perfected by filing and the other by a different means, e.g., possession, particularly if the filing antedates the other means of perfection, determining priorities may be confusing.\(^7\) The likelihood of this occurring is great in a transaction involving financing grounded on documents as collateral.

The chances for conflict over priorities between secured parties are proportional to the possible means of perfection and the various possibilities for the time of attachment of security interests. Even the bank that is cautious enough to file on goods, documents, proceeds and accounts (such complete coverage is desirable unless there is reason to accept less) and further holds negotiable documents as its collateral, may find itself challenged by other secured parties: persons claiming purchase money security interests, priority under negotiable documents, priority in accounts and priority in proceeds based on purchase money security interests in inventory and under negotiable documents.

An analysis of how such conflicting claims may arise and a discussion of their resolution is less appropriate than simple recognition of their possible origins. Since the problem is covered elsewhere,\(^8\) the following discussion is confined to questions of priority which arise upon or subsequent to the release of documents or

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\(^7\) See 2 Gilmore § 34.5, at 911-15.

goods. It ignores third-party secured creditors who might, even before release, have been able to claim a conflicting interest.

2. Release on Trust Receipt—Priorities Among Competing Documents

a. The mechanics. The warehouseman may request the bank to release warehouse receipts to him so that he can sell the goods, change the place of storage or the like. The standard practice is to release documents upon trust receipt delivered to the bank in place of the document of title. As previously noted, perfection in the goods and documents continues for twenty-one days after a secured party with a perfected security interest makes goods or documents available to the debtor for sale or exchange or related purposes, and for ten days in any proceeds generated by the goods or documents. These are grace periods and may be extended by appropriate filings.

During the twenty-one day period, the rights of the secured party in the document or goods may be terminated by a bona fide purchaser pursuant to sections 9-307(1) and 7-205. During the ten-day period, rights in proceeds may be lost under section 9-306 if the proceeds become unidentifiable.

There is question that without filing on goods, section 9-304 may provide continued perfection of the bank’s security interest in the goods and if a third-party has previously filed on them, his interest the bank is perfected as to both the documents and goods covered for twenty-one days despite redelivery—if the bank has not filed on the goods and if a third party has previously filed on them, his interest might advance on the scale of priorities and attach to the goods upon redelivery of the document to the debtor. This stems from the negative inference implicit in section 9-304(2) providing:

During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

In other words, the only way to perfect in the case of negotiable documents is by possession. By negative implication, the converse is that if at a certain point in time there is no filing as to goods and the

99. See note 87 supra, and accompanying text.
document is not in possession, someone might perfect a security interest in the goods. Likewise, if perfection on goods covered by a non-negotiable document has been achieved without filing either by issuance of the document in the name of the secured party or by notification to the bailee of the secured party’s interest, one might argue for the same result. This should not be the result in any case since section 9-304(5)(a) recognizes a continuing security interest where documents are released. If the security interest is continuing, presumably there is nothing for the prior interest to claim. The solution is to avoid any question by filing as to both goods and documents and verifying that there is no prior filing.

b. The Philadelphia National Bank Case. There are no cases under the sections of the Code dealing with the basic hypothetical case, but the opinion of Carl W. Funk who arbitrated Philadelphia National Bank, has been published in Funk, Trust Receipt v. Warehouse Receipts—Which Prevails When They Cover the Same Goods? This “decision” has been celebrated for its astute reasoning and may serve as a guide in all situations involving priorities among document holders.

Boody was financing Wool Company and filed on both documents of title and wool in Wool Company’s possession. Wool Company delivered a trust receipt to Boody and obtained delivery of wool. Wool Company then placed the wool in a public warehouse. Wool Company had the warehouse issue a non-negotiable warehouse receipt to Wagman as security for a loan. Neither Wagman nor the warehouseman knew of Boody’s earlier security interest in the goods. Wool Company became insolvent and it was discovered that the wool was covered both by Boody’s trust receipt and Wagman’s warehouse receipt.

It was stipulated that both Boody and Wagman had perfected security interests. Boody through filing on documents and goods and holding a trust receipt and Wagman by virtue of a non-negotiable warehouse receipt issued in its name. The arbitrator examined the rules of priority in section 9-312 and determined that since one of the interests was not perfected by filing, section 9-312(5)(b), the “first to perfect rule,” was the starting point for determining priorities. Boody,

100 See 2 GILMORE § 26.7, at 698.
the first-to-perfect, appeared to be the winner. The arbitrator pointed out that if Wagman had a purchase money interest, it might have prevailed under section 9-312(3). Additionally, if Wagman had been a buyer in the ordinary course of business, it would have taken free of Boody’s security interest under section 9-307. However, Wagman was not a buyer in the ordinary course of business since “buying” defined by section 1-201(9) does not include a transfer as security.

Recognizing that this priority dispute involved competition between documents, the arbitrator turned elsewhere to determine whether any other provision would override Boody’s apparent victory. It was noted that section 9-312(1) made section 9-309 controlling on priorities of security interests in documents. Section 9-309 thus was the deciding factor for Boody:

Nothing in this Article limits the rights of a holder in due course of a negotiable instrument. . . or a holder to whom a negotiable document of title has been duly negotiated. . . and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders or purchasers.

Under this section, if Wagman had taken a negotiable warehouse receipt and if the receipt has been duly negotiated according to section 7-501, Wagman could have prevailed over Boody who held a mere trust receipt. This case illustrates that negotiable receipts should always be taken as collateral.

In the Boody dispute, the arbitrator found that Article 7 was not inconsistent with the result since particular attention was given to section 7-503(1) which reads:

(1) A document of title confers no right in goods against a person who before issuance of the document had a legal interest or perfected security interest in them and who neither:
(a) delivered or entrusted them or any document of title covering them to the bailor with actual or apparent authority to ship, store or sell or with power to obtain delivery under this Article [(Section 7-403) dealing with the obligation of the warehouseman to deliver] or with power of disposition under this Act [(Sections 2-403 and 9-307) dealing with power to pass title to a buyer in the ordinary course of business] or other statute or rule of law; nor
(b) acquiesced in the procurement of the bailor or his nominee of any document of title. (Bracketed material added.)

It was argued that since Boody did entrust documents and goods to
Wool County thus enabling it to create the conflict, the converse of this language should cause Wagman’s document of title to confer paramount rights. The arbitrator found, however, that section 7-503(1) did not compel that result and that the Code did not divest an entrustor such as Boody of all its rights.

The implication to be drawn from [§7-503(1)] is that where entrusting occurs (under circumstances where there is authority to ship, store, sell, dispose of, obtain delivery or a document of title) and a document is then issued, the holder of that document (here being Wagman) acquires some rights. What they are must be found elsewhere in the Code. The Comments show clearly that the draftsmen [of §7-503(1)] were thinking primarily of the situation where a ‘commercial trustee’ sold the goods to a buyer in the ordinary course of business or procured a negotiable document of title which he negotiated to someone else . . . . There is nothing in the Comments to indicate that it was intended to confer a similar paramount position on the holder of a non-negotiable document, and the section therefore does not override the priority granted to Boody by Article 9, nor is it inconsistent with anything in that Article.102

The arbitrator must have assumed that the bailment by Wool Company was authorized or that Boody acquiesced in the procurement by Wool Company of a document of title. Otherwise, the document held by Wagman would have been the fruit of an unauthorized bailment and would have under section 7-503(1), prima facie, conferred no rights.103

The Boody arbitrator submits that under the Uniform Warehouse Receipts Act, a person to whom a receipt was transferred but not negotiated acquired no better title to the goods than that possessed by his transferee. And, furthermore, that the Uniform Act drew a distinction similar to the Code’s distinction between due negotiation, or negotiable receipts, and the acceptance of non-negotiable receipts. Although the Uniform Trust Receipts Act exposed an entrustor to

102. Id. at 633 (parenthetical remarks supplied).
103 Compare Brolcher at 62-63. See also Dunagan v. Griffin, 151 S.W.2d 250 (Tex. Civ. App. 1941), where cases of beer which had been entrusted to a carrier for transport were placed in a warehouse and the negotiable receipt thereby procured pledged for a loan. The true owner of the beer was able to assert paramount title to that of the pledgee, the court stating that the carrier could no more pass title to the beer by way of the receipt than he could by way of sale of the goods. Id. at 254. However, even a non-negotiable document could defeat the rights of an entrustor if the trustee procuring the document had a power of disposition—if, for example, he was a dealer in the goods, and sold the document instead of pledging it. See 2 Gilmore § 25.4, at 665-66.
loss if the trustee obtained and wrongfully negotiated a negotiable document or sold the goods to buyers in the ordinary course of trade, there was no protection for a pledgee, (by definition, not a buyer in the ordinary course of business) or another taking a non-negotiable document from the trustee. The arbitrator concluded:

If, as a matter of policy, the rule should now be changed to meet the demands of commerce, and non-negotiable receipts issued in the name of a bank and delivered to it should be given the same protection as negotiable receipts similarly delivered, this must be done by amendment to the Code. 105

It appears that the arbitrator could have relied more upon section 7-504. Had he referred to it, he would not have felt compelled to refer to the law under the Uniform Trust Receipts Act. Section 7-504 provides:

(1) A transferee of a document whether negotiable or non-negotiable, to whom the document has been delivered but not duly negotiated, acquires the title and rights which his transferor had or had actual authority to convey. 106

Wagman, as a transferee of a non-negotiable document, obtains only such rights as his transferor, Wool Company. Wool Company had no actual authority to convey any interest. To the contrary, transfer of any interest was presumably interdicted by Boody’s trust receipt. Comment 2 to section 7-504 recognizes that transfer of the non-negotiable document contrasts with transfer of the goods themselves as estoppel and agency principals will not, in the case of a non-negotiable document, avail to give the transferor power to convey greater rights than he actually has by using non-negotiable receipts. It is unnecessary to rely on estoppel or agency in the case of one who holds a negotiable receipt. He will prevail over anyone at any time. There is nothing an inventory financer can do to defeat the right of one taking by due negotiation from one who holds the inventory for sale. 107

c. Epilogue. The bank has priority over a subsequent pledgee of goods (upon release of documents or goods) only where the

105. Funk, note 101 supra, at 635.
106. U.C.C. § 7-504.
107. 2 GILMORE § 25.4, at 666.
subsequent pledgee takes a non-negotiable receipt or where the bank is the first to file. In other cases, as in the case of sale, the bank’s right depends upon its ability to trace proceeds as provided in section 9-306.

Another reason for taking a negotiable receipt is that only under a negotiable document can the bank terminate the rights of an unpaid seller of the pledged goods. This, however, produces the anomalous result of one without title, or with voidable title, little better than a thief, being able to pass better title than he could by virtue of having procured negotiable receipts under section 7-503(1)(a). In this situation, because the holder of the legal interest delivered the goods under circumstances that enabled the bailee to obtain delivery, the bailee can cut off the seller’s equities. The pledgee gets not only his pledgor’s title, but also that title the pledgor is able to convey to a purchaser in good faith for value.

3. Priorities Where Competing Claimants Do Not Hold Documents

The Philadelphia National Bank case will dispose of any contest between competing secured parties who, as a result of either repledge or sale, are both asserting rights derived from documents. One can visualize, however, competitors who do not claim under documents. If a bank releases on trust receipt or otherwise takes advantage of the twenty-one day period of section 9-304(4) for perfection without filing or possession the possible sources for competing claims by non-document holders would be limited to four:

1. A buyer in the ordinary course of business—he wins against the bank.\textsuperscript{110}

2. A buyer not in the ordinary course of business—he loses against the bank.\textsuperscript{111}

3. One who has filed on the goods themselves, before release of the document, e.g., an inventory financer under an after acquired property clause—he wins against the bank claiming under a non-

\textsuperscript{108} See Braucher at 76-77.

\textsuperscript{109} The four named are the most obvious. Some competitors who are not so obvious and their relative rights are discussed in the authorities cited at note 98 supra. The rights of these not-so-obvious competitors would all, however, be at least inchoate by the time the bank releases on trust receipt.

\textsuperscript{110} U.C.C \textsuperscript{2} 2-403, 7-205, 9-307(1); see 2 Gilmore \textsuperscript{2} 26.6. It is to be remembered that a “buyer” under U.C.C. \textsuperscript{1} 2-403(9) does not include a pledgee.

\textsuperscript{111} U.C.C \textsuperscript{2} 2-403, 7-205, 9-307(1); see 2 Gilmore \textsuperscript{2} 26.6.
negotiable document, loses against the bank claiming under a negotiable document.\textsuperscript{112}

4. One who has filed on the goods themselves after release of the document—he loses to the bank.\textsuperscript{113}

\textit{D. Competition For Proceeds}

1. \textit{The Possible Competitors}

Still to be considered is what the bank has remaining if the documents and goods are gone and only the proceeds remain. As noted, the Code makes some distinctions between proceeds held by solvent and insolvent debtors. Proceeds in the hands of insolvent debtors, or the trustee in bankruptcy will be treated later.

First, a security interest in "identifiable" proceeds is good for 10 days without filing, or continuously if a financing statement covering proceeds has been filed.\textsuperscript{114} It is important to recognize that only "identifiable" proceeds may be directly traced into the hands of third parties and the bank cannot reclaim the delinquent debtor's dissipations without discretion. Although the bank's right to set-off cannot be denigrated,\textsuperscript{115} deposits in another bank will cause proceeds such as checks to lose their "identifiable" nature and put such funds beyond reach, except in the case of insolvency.

Once "identifiable" proceeds are located, it may be necessary to compete for them with other secured parties. For example, if the bank locates the proceeds of a sale in the form of an account, the bank might be confronted by another secured party who is financing receivables. There might be one claiming that he, and not the bank,

\textsuperscript{112} Since there is a distinction between a non-negotiable document and the goods themselves, as previously pointed out, the general priority rule of U.C.C. § 9-312(3) governs here and grants the encumbrancer of after-acquired property priority against any bank which cannot qualify for purchase money priority under U.C.C. § 9-309. Professor Gilmore feels that the future advance priority problem is unlikely to arise where documents are involved so long as the document holder attains the status of a duly negotiated holder. 2 Gilmore § 35.8, at 943.

\textsuperscript{113} It has already been discussed and resolved that this case presents a question which should be resolved in favor of the bank. See text following note 99 supra.

\textsuperscript{114} U.C.C. § 9-306(3).

\textsuperscript{115} See generally, Bankruptcy Act § 68, 11 U.S.C. § 108 (1964); 10 Am. Jur. 2d Banks §§ 669-71 (1963). The right to set-off, however, may be qualified in any state which does not recognize the right to set-off the unmatured debt of an insolvent depositor, e.g., Brown v. Stotts City Bank, 327 Mo. 753, 38 S.W.2d 722 (1931). Maturity of the indebtedness is not a qualification under the Bankruptcy Act, 9 Am. Jur. 2d Bankruptcy § 514 (1963), so the obvious answer is to include an acceleration provision conditioned on insolvency in any course of financing.
was prior in right with respect to the underlying collateral. Ignore this claimant for he might be: a purchase money man; a non-purchase money inventory man filed on after acquired property and proceeds where the bank was not; one who had released goods covered by documents on trust receipt and filed as to goods, documents and proceeds; or any variation of these.

2. The Adverse Secured Party—Accounts

To simplify discussion, the adverse secured party claiming under a purchase money security interest that has "shifted," enabling him to assert a continuing priority in proceeds, will be ignored. There is no satisfactory solution to that problem. Neither will the claims to proceeds arising from an earlier priority in the underlying collateral be discussed. Whether or not an interest in proceeds should be or is entitled to the same priority as the interest in the original collateral is unresolved.

The Code does not seek to resolve contests between secured parties for proceeds when neither party can identify their source. Since the sine qua non of the assertion of rights to proceeds is the identification of the proceeds generated by one's collateral, for secured parties A and B to be disputing the same proceeds simply means that one, or both, are unable to accurately identify the proceeds of his collateral. If proceeds are identifiable they may be pursued. If proceeds are not identifiable, they are lost, except in the case of cash in bank accounts. The Code resolves only the conflict between A claiming the proceeds qua proceeds and B claiming the same items as accounts or original collateral. The exception to this is the case of a competing secured party asserting a claim to the same underlying collateral.

In the case of the warehouseman who sold a bank's collateral, the proceeds of sale will usually be limited to cash, negotiable instruments in the form of checks, drafts or accounts. If the proceeds are cash which has been mingled in a bank account or with other cash, they

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116 2 GILMORE § 29.4. After a trip through a statutory chamber of horrors, Professor Gilmore himself states it it would be folly to predict what a court would do in the case of a purchase money secured party claiming a continuing priority in proceeds which were, say, accounts, over a party who has previously filed on accounts, and describes his analysis as constituting "... as undigestible a passage as can be found in the entire range of the legal literature." ID at 796.

117 See authorities cited note 98, supra.

118 See e.g., COOGAN & GORDON, supra note 98, at 1557 et seq; Henson, supra note 98, at text following note 27; Moyle, supra note 96, at 1017.
are no longer identifiable and the lender will suffer the loss,\textsuperscript{119} unless, the lender is a bank and the right to set-off can be exercised or unless actual insolvency has occurred.\textsuperscript{120} If the proceeds are negotiable instruments, they likewise are beyond reach to the extent they have been negotiated.\textsuperscript{121}

If the proceeds are accounts, the answer is not as simple. The Code by not referring to accounts in the priority context, recognizes the lack of pre-Code litigation with respect to proceeds other than chattel paper and non-negotiable instruments.\textsuperscript{122} Consequently, there are no special rules for determining priorities between an inventory financer holding a derivative claim to an account as proceeds and the financer of receivables whose claim to an account is direct.\textsuperscript{123} With no Code provision giving the purchaser of an account priority over one who has a perfected interest in the account derived from a continuing interest in inventory, perhaps the inventory secured party should take precedence over the receivables financer.\textsuperscript{124} Alternatively, there is a continuity of perfection extending to proceeds which began as a security interest in inventory, so that the account is already encumbered when created, leaving nothing that the account receivable financer’s interest can attach.

There is no clear order of priorities in proceeds.\textsuperscript{125} To avoid this problem, debtors must be required to deposit cash and negotiable proceeds in a collateral account and financers must not rely on receivables as collateral unless priority is assured through proper filing.

3. The Trustee in Bankruptcy—Proceeds

The Code relaxes the rules somewhat when tracing cash proceeds on insolvency. In substance, section 9-306(4) provides that in the event of

\footnotesize{\textsuperscript{119} See 2 GILMORE § 27.4, at 735.}
\footnotesize{\textsuperscript{120} If actual insolvency has occurred, the special rule of U.C.C. § 9-306(4), hereinafter discussed, will extend some rights to mingled bank accounts.}
\footnotesize{\textsuperscript{121} U.C.C. § 9-306.}
\footnotesize{\textsuperscript{122} U.C.C. § 9-308 (purchasers giving new value and taking possession of chattel paper or non-negotiable instruments may take free of prior perfected security interest if without knowledge of the interest). See generally 2 GILMORE §§ 25.5, 27.3.}
\footnotesize{\textsuperscript{123} 2 GILMORE § 27.4, at 733.}
\footnotesize{\textsuperscript{124} 2 GILMORE § 27.4, at 732-33. Professor Gilmore notes the problem of competition between the purchase money inventory financer claiming accounts as proceeds and the receivables secured party making advances against accounts as they arise. \textit{Id.} at n.5.}
\footnotesize{\textsuperscript{125} 2 GILMORE §§ 29.3, 29.4, 34.4, 34.5; Coogan & Gordon, supra note 98, at 1555-58; Henson, supra note 98; Moye, supra note 96, and authorities cited therein.}
insolvency, the secured party with a perfected interest in proceeds has a perfected security interest in (a) identifiable non-cash proceeds, (b) identifiable cash proceeds (i.e., cash which has not been commingled), (c) identifiable cash proceeds such as checks which have not been deposited in a bank account and (d) in all cash and bank accounts of the debtor. However, the secured party's interest in such commingled funds is (a) subject to the right of setoff and (b) further limited by the somewhat complicated formula of section 9-306(4)(d)(ii) which prohibits reaching any funds which have been in the account more than ten days.128 The significance of this section is that mingling, when insolvency is involved, does not preclude tracing the proceeds to their source. Additionally, the secured party need not show that any portion of a bank account is a product of the sale of his collateral in order to claim an interest in the mingled fund.127 While commentators recognize a historical stumbling block in this provision, which appears to give the secured party an automatic priority in assets unencumbered to the time of insolvency, it is agreed that this is not the effect of the provision and that it should withstand attack.128

**Conclusion**

It is gratifying that there are not more difficulties in the application of the Code to this topic. Despite a few complexities and uncertainties, in nearly every instance where complexities render the outcome uncertain, alert forecasting will avert dealing with them. For instance, the simple expedient of checking state law for peculiar requirements imposed upon warehousemen will avoid arguing Code pre-emption with regard to regularity in form and issuance of receipts. Furthermore, there is little chance of a conflicting claim to collateral if appropriate filings are made, particularly if the lender is aware of the expedience of being a "duly negotiated holder."

Nor should one neglect the importance of business efficiency in financing warehousemen. The primary dictates of financing consist of knowledge of the debtor and strict adherence to a program of supervision including constant communication with the debtor when

126 Professor Gilmore restates the formula and lists the steps involved in its application in 2 Gilmore § 45-9, at 1338-39.
127 Id.
128 Id. at 1339-44; Henson, "Proceeds" under the Uniform Commercial Code, 65 Colum. L. Rev. 232 (1965).
goods are released on trust receipt. Collateral consisting of fungibles is highly volatile in that, through warehouse receipts and bills of lading, it can be readily dissipated. It is also volatile because it can be created by the stroke of a pen where it doesn’t exist and removed by operation of law through no fault of the warehouseman. A survey of the practical commentary on the subject of financing on warehouse receipts will provide ample suggestions for reducing such risks.\footnote{129}

It is hoped that Code revisionists will consider the doctrine of appropriation as applied to the warehouseman’s own creditors and some of the unique questions of priority created by the later secured party taking negotiable documents. Until these areas are clarified, an appreciative approach to financing the warehouseman on his own fungibles will save considerable uncertainty.