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**Comparing the United States
Warehouse Act and U.C.C. Article 7**

by

Drew L. Kershen

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COMPARING THE UNITED STATES WAREHOUSE ACT AND U.C.C. ARTICLE 7

DREW L. KERSHENT†

I. GENERAL BACKGROUND INFORMATION

A. LEGISLATIVE ACTIONS

Congress adopted the United States Warehouse Act ("Act") in 1916.¹ Since that date, Congress has passed three significant amendments to the Act. In 1931, Congress conferred exclusive jurisdiction over all persons securing a license under the Act upon the United States Secretary of Agriculture.² In 1990 and 1992, Congress authorized the Secretary of Agriculture to create a central filing system for electronic cotton warehouse receipts.³ Aside from these amendments, there has been minimal legislative activity.

B. JUDICIAL ACTIONS

Despite the thousands of transactions and the billions of dollars of agricultural products under warehouse receipts each year, the number of reported cases is surprisingly small. Fewer than one case every two years involves a dispute concerning warehouse receipts issued by warehouses licensed under the Act. One would be hard pressed to find another federal statute of this magnitude that has produced such little case law.

† Earl Sneed Centennial Professor of Law, University of Oklahoma College of Law. B.A. University of Notre Dame (1966); J.D. University of Texas (1968); LL.M. Harvard University (1975). Chair of the Article 7 Task Force of the Uniform Commercial Code Committee of the Section on Business Law of the American Bar Association (ABA). The author is fully responsible for the content, organization, and opinion in this article. The ABA affiliation is for identification purposes only and does not indicate any knowledge or approval of this article by the ABA.

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1. United States Warehouse Act, 7 U.S.C. §§ 241-73 (1988).
2. 7 U.S.C. §§ 241-73 (1988) (amended Mar. 2, 1931).
3. 7 U.S.C. §§ 241-73 (amended Nov. 28, 1990 and Oct. 28, 1992).

C. SCOPE OF THE ACT

The Act provides regulatory licensing for agricultural warehouses and also fosters confidence in warehouse receipts as commercial documents of title.⁴ In contrast, Article 7 of the Uniform Commercial Code ("Article 7") is concerned solely with commercial trade in documents of title. Sections 7-103 and 10-104 of the Uniform Commercial Code ("U.C.C.") make explicit that the U.C.C. neither repeals nor replaces the regulatory licensing acts of the various states for warehouses.

The Act is expressly limited to warehouses that store agricultural products.⁵ The Act has no application to nonagricultural products and nonwarehouse bailments. In contrast, Article 7 covers bailments for all products and both the storage and transportation of products.

D. COMPARABLE PROVISIONS

The regulatory sections of the Act have no comparable provisions in Article 7. Excluding the regulatory sections of the Act, there are only seven sections of the Act that have comparable sections in Article 7. Those sections are as follows:

United States Warehouse Act	U.C.C. Sections	Discussed in Text at
§ 242. Definitions	§ 1-201 & § 7-102. Definitions	Part III
§ 258. Mingling products stored	§ 7-207. Goods Must be Kept Separate; Fungible Goods	Part III(f)(1) and Part III(i)

4. *United States v. Kirby*, 587 F.2d 876, 880 (7th Cir. 1978). For an overview of the Act, see 1 JULIAN CONRAD JUERGENSMEYER & JAMES BRYCE WADLEY, *AGRICULTURAL LAW* §§ 20.1-20.6 (1982).

5. 7 U.C.C. § 242 (1988).

United States Warehouse Act	U.C.C. Sections	Discussed in Text at
§ 259(a). Receipts for products stored	§ 7-201. Who May Issue a Warehouse Receipt; Storage Under Government Bond — § 7-203. Liability for Non-receipt or Misdescription — § 7-401. Irregularities in Issue of Receipt or Bill or Conduct of Issuer — § 7-402. Duplicate Receipt or Bill; Overissue; § 7-501. Form of Negotiation and Requirements of “Due Negotiation” — § 7-502. Rights Acquired by Due Negotiation	Part III(b)
Cf. § 259(c) — Nothing directly comparable	§ 7-501. Form of Negotiation and Requirements of “Due Negotiation” — § 7-502. Rights Acquired by Due Negotiation — § 7-503. Document of Title to Goods Defeated in Certain Cases — § 7-504. Rights Acquired in the Absence of Due Negotiation; Effect of Diversion; Seller’s Stoppage of Delivery	Part III(f)(3)
§ 260. Contents of receipts	§ 1-201(15). Document of Title — § 7-202. Form of Warehouse Receipt; Essential Terms; Optional Terms	Part III(a)

United States Warehouse Act	U.C.C. Sections	Discussed in Text at
§ 260. Contents of receipts	§ 7-104. Negotiable and Non-negotiable Warehouse Receipts, Bills of Lading or Other Documents of Title — § 7-203. Liability for Non-receipt or Misdescription — § 7-501. Form of Negotiation and Requirements of "Due Negotiation"	Part III(c)
Cf. § 260(j). Contents of receipts — § 262(a). Delivery of products stored on demand; Conditions of delivery — Nothing directly comparable	§ 7-209. Lien of Warehouseman	Part III(d) and Part III(f)(2)
§ 261. Issuance of further receipt with original outstanding	§ 7-402. Duplicate Receipt or Bill; Overissue — § 7-601. Lost and Missing Documents	Part III(g)
§ 262. Delivery of products stored on demand; conditions of delivery	§ 7-104. Negotiable and Non-Negotiable Warehouse Receipt, Bill of Lading or Other Document of Title — § 7-403. Obligation of Warehouseman or Carrier to Deliver; Excuse — § 7-506. Delivery Without Instrument; Right to Compel Indorsement	Part III(h)
§ 263. Cancellation of receipt on delivery of product stored	§ 7-403(3). Obligation of Warehouseman or Carrier to Deliver; Excuse	Part III(h)

United States Warehouse Act	U.C.C. Sections	Discussed in Text at
Nothing directly comparable	§ 7-204. Duty of Care; Contractual Limitation of Warehouseman's Liability — § 7-403(1)&(2). Obligation of Warehouseman or Carrier to Deliver; Excuse	Part III(e)

In addition to the statutory provisions of the Act, Congress expressly granted the Secretary of Agriculture the authority to issue rules and regulations to carry out the provisions of the Act.⁶ Pursuant to this delegated authority, the Secretary has promulgated a series of regulations for agricultural warehouses.⁷ These regulations relate to the licensing of warehouses, the bonding of warehouses, warehouse receipts, duties of warehouse operators, fees, licensing of classifiers/ graders and weighers, commodity classification/grading, and appeals. Only the regulations concerning warehouse receipts have sections comparable to provisions in Article 7, which concern documents of title. The other topics addressed by the regulations are not within the purview of Article 7. Only in a few instances are any regulations on these nonwarehouse receipts topics addressing issues that might arise under Article 7.

6. *Id.* § 268.

7. 7 C.F.R. §§ 735-42 (1993). United States Department of Agriculture ("USDA") regulations on warehouses are found in 7 C.F.R. as follows: Part 735 (Cotton Warehouses); Part 736 (Grain Warehouses); Part 737 (Tobacco Warehouses); Part 738 (Wool Warehouses); Part 739 (Dry Bean Warehouses); Part 740 (Nut Warehouses); Part 741 (Syrup Warehouses); Part 742 (Cottonseed Warehouses). The USDA divided the regulations by agricultural product to respond to the special trade practices that exist with respect to the warehousing of the individual agricultural products. However, a moderate examination of the regulations for the different commodity warehouses reveals substantial similarity among all the warehouse regulations regardless of the specific agricultural product covered.

In light of this substantial similarity, the author will most often cite regulations from Part 736, relating to grain warehouses. Citations to grain warehouse regulations are meant to typify USDA regulations, but attorneys should be careful to look at the specific regulations for the precise commodity warehouse involved when confronted with a client's factual situation.

II. PREEMPTION RELATIONSHIP BETWEEN THE ACT AND U.C.C. ARTICLE 7

Lawyers who practice agricultural commercial law usually think of *United States v. Kimbell Foods, Inc.*⁸ as setting forth the preemption paradigm between federal law and the Uniform Commercial Code ("U.C.C."). Under the *Kimbell* analysis, even though federal law controls, courts are expected to adopt nondiscriminatory state law as the content of federal commercial law. For example, a Farmers Home Administration ("FmHA") borrower can use a state's redemption right even though no explicit federal redemption right exists and even though federal law controls the relationship between the FmHA and the borrower.⁹ Consequently, even when federal law controls, federal commercial law in practice does not differ from state commercial law.

The preemption paradigm governing the United States Warehouse Act ("Act") and Article 7 of the Uniform Commercial Code ("Article 7") differs. In cases like *Kimbell*, courts face situations where no federal act and accompanying regulations are applicable to the legal and factual issues in the case. In contrast, the Act and its accompanying regulations provide the applicable federal law for warehouse receipts issued by warehouses licensed under the Act. Thus, courts must respect federal law. Section 7-103 of the U.C.C. acknowledges the supremacy of federal law by expressly making the provisions of Article 7 subject to federal statutes and treaties.¹⁰

Even though the Act provides applicable federal law, the Act itself does not explicitly provide when it preempts conflicting state law, including Article 7. In *Rice v. Santa Fe Elevator Corp.*,¹¹ the United States Supreme Court set forth the precise preemption standard between the Act and state law. According to the Court, "The test, therefore, is whether the matter on which the State asserts the right to act is in any way regulated by the Federal Act. If it is, the federal scheme prevails though it is a more modest, less pervasive regulatory plan than that of the State."¹² If the Act addresses a particular matter, the federal law fully preempts state law.¹³ However, the Court stated

8. 440 U.S. 715 (1979).

9. *United States v. Ellis*, 714 F.2d 953, 957 (9th Cir. 1983); *see also*, *United States v. Einum*, 992 F.2d 761 (7th Cir. 1993).

10. U.C.C. § 7-103. One purpose of U.C.C. section 7-103 is "[t]o make clear what would of course be true without the Section, that applicable Federal law is paramount." *Id.* cmt. 1.

11. 331 U.S. 218 (1947).

12. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 236 (1947).

13. *See Demeter, Inc. v. Werries*, 676 F. Supp. 882, 887 (C.D. Ill. 1988) (holding that the Act fully preempts federally licensed warehouses from complying with an Illinois statute creating the Illinois Grain Insurance Fund, which gets its money through a per bushel assessment, as security for depositors). *See also Duluth Bd. of Trade v.*

that if the Act did not address a particular matter, then the "conflicts between federal and state law" preemption paradigm would control the issue.¹⁴

In light of the preemption paradigm of the *Rice* case, the Act preempts Article 7 much more often than federal law preempts state commercial law under the *Kimbell* standard. As previously stated, seven sections of the Act are comparable to sections in Article 7. Under the *Rice* preemption test, these seven sections of the Act fully preempt federally licensed warehouses from the comparable provisions of Article 7.¹⁵ Due to full preemption where comparable provisions exist, federal law under the Act for warehouse receipts may be substantively different from state law for documents of title (warehouse receipts) under Article 7.

III. SUBSTANTIVE COMPARISON OF THE ACT AND ARTICLE 7

A. THE FORM AND CONTENTS OF WAREHOUSE RECEIPTS

Uniform Commercial Code ("U.C.C.") section 7-202(1) is clear: "A warehouse receipt need not be in any particular form."¹⁶ Moreover, U.C.C. section 1-201(15) defines document of title to include "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 document and the goods it covers."¹⁷ With these two provisions as background, courts have recognized scale tickets or weight slips¹⁸ and canceled checks¹⁹ as docu-

Head, 298 F. Supp. 678, 682 (D. Minn. 1969) (holding that Minnesota law regarding the form of weight receipts was preempted by United States Warehouse Act for federally licensed warehouses).

14. *Rice*, 331 U.S. at 237. The "conflicts between federal and state law" preemption paradigm dictates that the federal law preempts state law only when the state law contradicts the federal law. In the *Rice* case, Justice Frankfurter, in dissent, argued for the adoption of the "conflicts between federal and state law" preemption paradigm as the correct standard to apply to cases involving all matters addressed both by the Act and state warehouse laws. *Id.* at 238-47.

15. Warehouses may apply for a federal license but are not required to be federally licensed. 7 U.S.C. § 244 (1988). The Act is permissive, not mandatory. Thus, a warehouse owner who desires to avoid the Act can do so simply by not applying for a federal warehouse license. However, some states have statutes that require warehouses to have either a federal license or a state license. *See, e.g., OKLA. STAT. tit. 2, § 9-22(A)* (1991).

16. U.C.C. § 7-202(1).

17. *Id.* § 1-201(15).

18. *In re Durand Milling Co., Inc.*, 9 B.R. 669, 671-72 (Bankr. E.D. Mich. 1981) (recognizing weight slips as documents of title). *But see, In re Biniecki Brothers*, 38 B.R. 519, 522 (Bankr. E.D. Mich. 1984) (refusing to treat scale tickets as documents of title).

19. *Midland Bean Co. v. Farmers State Bank*, 552 P.2d 317, 321 (Colo. Ct. App. 1976).

ments of title under Article 7 of the U.C.C. ("Article 7").²⁰ As documents of title, holders of scale tickets, weight slips, or canceled checks were given the opportunity, but not the guarantee, of entitlement to protections afforded holders under Article 7.

Section 260 of the United States Warehouse Act ("Act") prescribes the contents of warehouse receipts. Section 260 sets forth content requirements that are substantially similar to the content requirements of U.C.C. section 7-202(2). However, section 260 contains no statutory language comparable to U.C.C. section 7-202(1), which expressly provides that no particular form is necessary. As a result of this difference in statutory language, how do courts treat scale tickets or weight slips issued by federally licensed warehouses?

In *Farmers Elevator Mutual Insurance Co. v. Jewett*,²¹ the United States Court of Appeals for the Tenth Circuit ruled that scale tickets held by farmers qualified for protection under the surety's bond even though the scale tickets did not comply with the Act or its regulations concerning the proper form for warehouse receipts. The court ruled that scale tickets were storage documents under the Act which thereby imposed upon the federally licensed warehouse the obligation to redeliver the stored wheat upon demand of the scale ticket holders.²² When the warehouse failed to redeliver upon demand, the bond provided security for the depositors in accordance with section 247 of the Act.²³ By so holding, the Tenth Circuit reached a conclusion that is compatible with U.C.C. section 7-202(1) cases, which make particular form unnecessary.²⁴

B. ILLEGALLY ISSUED WAREHOUSE RECEIPTS

Section 7-401 of the U.C.C. imposes obligations on the issuer of a document of title, even though the document was issued in violation of laws regulating warehouses. The Official Comments to section 7-401 indicate that the drafters had three purposes for adopting this section. First, issuers should not be able to avoid their obligations under a doc-

20. Drew L. Kershen, *Article 7: Documents of Title*, 48 *BUS. LAW.* 1645 (1993). Compare *In re Celotex*, 134 B.R. 993, 998 (Bankr. M.D. Fla. 1991) (holding that monthly service statements, invoices, and injection volume documents did not qualify as documents of title because they did not satisfy the terminological or informational requirements of U.C.C. § 7-202(2)) with *In re Julien Co.*, 136 B.R. 755, 759 (Bankr. W.D. Tenn. 1991) (concluding that warehouse receipts need not meet terminological requirements of U.C.C. § 7-202(2)).

21. 394 F.2d 896 (10th Cir. 1968).

22. *Farmers Elevator Mut. Ins. Co. v. Jewett*, 394 F.2d 896, 899-900 (10th Cir. 1968).

23. *Id.* at 900.

24. For similar treatment of scale tickets as documents of title under the Act, see *Lee v. Bartlett & Co.*, 121 B.R. 872 (D. Kan. 1990).

ument of title by claiming that the document is invalid. Second, those acquiring invalid documents of title should be protected from arguments as to the invalidity of the document in order to protect the commercial trade in documents of title. Protecting the commercial viability of documents of title is the primary purpose of Article 7. Third, the appropriate sanctions for issuing invalid documents of title are regulatory sanctions against warehouses under warehouse licensing laws. By using regulatory sanctions against warehouses, adequate enforcement exists without declaring the documents themselves invalid.²⁵

The fact pattern that most clearly illustrates U.C.C. section 7-401 occurs when a warehouse issues warehouse receipts for goods that are not stored in its warehouse. Most state warehouse regulatory laws and section 259 of the Act expressly forbid the issuing of warehouse receipts unless the products covered by the receipts are in storage at the time of issuance. Thus, warehouse receipts issued for phantom goods are invalid. What are the consequences of this invalidity upon the obligations of the issuer and the rights of holders of these invalid documents?

In *State ex rel. Public Service Commission v. R.F. Gunkelman & Sons, Inc.*,²⁶ the Supreme Court of North Dakota correctly construed U.C.C. section 7-401 to mean that the issuer could not deny its obligations for warehouse receipts issued without actual delivery of grain into storage.²⁷ The court correctly understood section 7-401 as declaring the invalidity argument as legally ineffective against the warehouse receipts issued in violation of North Dakota warehouse regulatory laws. Thus, the issuer of the warehouse receipts could not find cover from its obligations through the invalidity argument.

Even though issuers cannot use the invalidity argument to avoid obligations for their issued documents of title, holders may not be successful in using the documents to assert their rights. Section 7-203 of the U.C.C. protects a good faith purchaser for value of a warehouse receipt for unstored goods unless the "purchaser otherwise has notice" that the warehouse is not storing the goods.²⁸ Moreover, a holder of a negotiable document of title under U.C.C. section 7-502 acquires title to the document and the goods it represents if the negotiable docu-

25. Section 7-401 impliedly rejects the holdings of cases such as *Central Nat'l Bank v. Fidelity & Deposit Co.*, 324 F.2d 830, 832 (7th Cir. 1963) (noting that holders of illegal warehouse receipts could not collect on the warehouse person's bond); *Fidelity State Bank v. Central Surety & Ins. Corp.* 228 F.2d 654, 647 (10th Cir. 1955) (same); *Central States Corp. v. Luther*, 215 F.2d 38, 42-43 (10th Cir. 1954) (same).

26. 219 N.W.2d 853 (N.D. 1974).

27. *State ex rel. Pub. Serv. Comm'n v. R.F. Gunkelman & Sons, Inc.*, 219 N.W.2d 853, 857 (N.D. 1974).

28. U.C.C. § 7-203.

ment was duly negotiated to the holder. Under U.C.C. section 7-501(4), due negotiation occurs when a holder purchases in good faith for value without notice of defenses or claims and with proper indorsement. Consequently, holders of warehouse receipts for unstored goods acquire rights under either section 7-203 or section 7-502 only if they are purchasers in good faith for value without notice.

In *Branch Banking & Trust Company v. Gill*,²⁹ the North Carolina Supreme Court held that the holder of warehouse receipts for unstored grain was not a good faith purchaser for value without notice.³⁰ The bank, as holder, lost because under the facts and circumstances known at the time it took the warehouse receipts, the bank had notice that the warehouse had stored no grain to support the issuance of the warehouse receipts.

The Act has no section comparable to U.C.C. section 7-401, but section 259 specifically prohibits a federally licensed warehouse from issuing warehouse receipts when no goods are received into storage. In light of these differences between the Act and Article 7, what is status of warehouse receipts for phantom goods under federal law?

The only relevant cases construing the Act were decided by the Georgia Supreme Court. In *Maryland Casualty Company v. Washington Loan & Banking Company*,³¹ and *National Bank v. Maryland Casualty Co.*,³² the Supreme Court of Georgia construed the Act in a manner similar to the North Dakota Supreme Court in *Gunkelman* and the North Carolina Supreme Court in *Gill*. In *Washington Loan & Banking Company*, the Georgia Supreme Court held the issuer to its obligations, even though the evidence strongly suggested that the warehouse receipts did not represent cotton stored or owned by the issuer. The court emphasized that the issuer of the warehouse receipts should be estopped from denying the validity of the receipts when no evidence existed showing that the bank knew of any irregularity in their issuance. In contrast, one year later in *National Bank*, the Georgia Supreme Court affirmed a verdict denying the holder of warehouse receipts rights under the receipts because the jury found that the bank had knowledge that the receipts were issued for phantom goods. Some language in the court's holding in *National Bank* seems to adopt an invalid document analysis, but the main thrust of the court's reasoning focuses on the bank's knowledge and good faith at the time the bank accepted the warehouse receipts as collateral for the loan.

29. 237 S.E.2d 21 (N.C. 1977).

30. *Branch Banking & Trust Co. v. Gill*, 237 S.E.2d 21, 37 (N.C. 1977).

31. 145 S.E. 761 (Ga. 1928).

32. 146 S.E. 739 (Ga. 1929).

After examining the cases concerning illegally issued warehouse receipts, there appears to be no substantive incompatibility between the Act and Article 7. While the statutory language of the two laws differ, courts have reached similar results in similar fact patterns under either law.

C. NEGOTIABILITY

A person who receives a negotiable warehouse receipt after proper indorsement and due negotiation "may acquire more rights than his transferor had."³³ The transferee acquires title to the negotiable document, the goods the negotiable document represents, and other rights of the bailee and obligations of the issuer which protect the transferee from almost all claims of paramount rights by other persons.³⁴ Consequently, negotiable warehouse receipts are equivalent to lawful currency. Like lawful currency, negotiable warehouse receipts must be carefully guarded, and the holder of a negotiable document of title, properly endorsed and duly negotiated, is presumed to be entitled to spend the negotiable document.³⁵ In contrast, if a person receives non-negotiable warehouse receipts or if a person takes negotiable warehouse receipts without proper indorsement or without due negotiation, then the transferee acquires the title and rights that the transferor had or had authority to convey.³⁶ Thus, negotiability is the most important attribute for documents of title and a key concept in Article 7.

Section 7-104 of the U.C.C. distinguishes negotiable from non-negotiable documents of title through terms in the document itself. A negotiable document is one that "by its terms the goods are to be delivered to bearer or to the order of a named person."³⁷ Documents must have these magic words to be negotiable. All other documents of title are nonnegotiable.³⁸ Section 7-202(2)(d) of the U.C.C. reinforces sec-

33. U.C.C. § 7-104 cmt.

34. *Id.* § 7-502(1).

35. *Id.* § 7-503 cmt. 1.

36. *Id.* § 7-504(1).

37. *Id.* § 7-104(1)(a).

38. For a case that rejects the magic words approach to negotiability, see *In re George B. Kerr, Inc.*, 25 B.R. 2 (Bankr. D.S.C. 1981), *aff'd without opinion* 696 F.2d 990 (4th Cir. 1982). In the *Kerr* case, the bankruptcy trustee disputed a bank's status as a perfected secured party. The bank held warehouse receipts. The bankruptcy court ruled that the receipts were negotiable and had been perfected through possession. Alternatively, the court ruled that if the receipts were non-negotiable, then the bank was a perfected secured party against the goods covered by the receipts. *Id.* at 7.

The author believes that the court was mistaken in its characterization of the receipts as negotiable but was correct in its decision that the bank had a properly perfected security interest against the goods covered by non-negotiable receipts. The receipts in *Kerr* did not contain the magic words of negotiability as required by U.C.C.

tion 7-104 by requiring that the document state "whether the goods received will be delivered to the bearer, to a specified person, or to a specified person or his order."³⁹ Finally, U.C.C. section 7-501 specifies how negotiable documents are indorsed: bearer documents are indorsed by delivery alone; to-the-order-of-a-named-person documents are indorsed by signature and delivery.⁴⁰

Even if the documents are negotiable and properly indorsed, the person to whom the documents are transferred cannot acquire the protections of negotiable warehouse receipts unless the transferee acquired the documents through due negotiation. Section 7-501(4) of the U.C.C. provides the eight elements of due negotiation: (1) proper indorsement; (2) to a holder; (3) who purchases; (4) in good faith; (5) without notice of competing claims or defenses; (6) for value; (7) in the regular course of business or financing; and (8) not in settlement of a prior money obligation. "Good faith" and "without notice" are separate elements, despite being quite similar and often present in the same factual pattern. Moreover, the good faith and without notice elements are often contentious issues in due negotiation disputes. Due negotiation disputes are common in cases involving competing claimants to goods stored under negotiable warehouse receipts.⁴¹

Section 260 of the Act requires each warehouse receipt to state "whether the agricultural products received will be delivered to the bearer, to a specified person, or to a specified person or his order."⁴² The language of section 260 is almost identical to U.C.C. section 7-202(1)(d). Building on the Section 260 language, United States Department of Agriculture ("USDA") regulations mandate that every warehouse receipt have "[t]he words "Not Negotiable," or "Negotiable," according to the nature of the receipt, clearly and conspicuously printed or stamped thereon."⁴³ However, the Act contains no statu-

§ 7-104(1). Moreover, the bankruptcy court did not take into account U.C.C. § 7-501(5), which explicitly states that signing non-negotiable receipts will not render them negotiable. Signatures on non-negotiable receipts are not indorsements. *See*, U.C.C. § 7-104 cmt. Moreover, the *Kerr* case focuses on the question of the perfected status of the secured party. Thus, the *Kerr* case can be distinguished from the discussion in the main text where the precise issue is negotiability itself, not the status of a party as perfected or unperfected under U.C.C. Article 9.

39. U.C.C. § 7-202(2)(d).

40. For a good discussion of indorsement for negotiable documents, see *R. E. Huntley Cotton Co. v. Fields*, 551 S.W.2d 472 (Tex. Civ. App. 1977).

41. *See, e.g.*, *Cleveland v. McNabb*, 312 F. Supp. 155, 160 (W.D. Tenn. 1970) (holding that warehouse receipts were not duly negotiated and thus did not impair plaintiff's crop lien); *Branch Bank & Trust Co. v. Gill*, 237 S.E.2d 21, 29 (N.C. 1977) (holding that the plaintiff bank did not acquire warehouse receipts through due negotiation); *R. E. Huntley Cotton Co.*, 551 S.W.2d at 475-76 (rejecting plaintiff's argument that warehouse receipts were not duly negotiated).

42. 7 U.S.C. § 260(d).

43. 7 C.F.R. § 736.18(a)(7) (1993).

tory provisions comparable to U.C.C. sections 7-104 and 7-501, which specifically define what makes a document negotiable, how negotiable documents are indorsed, or what constitutes due negotiation.

In *Peoples Warehouse Company v. Commercial Bank & Trust Company*,⁴⁴ the Georgia Court of Appeals discussed negotiability of federal warehouse receipts under section 260 of the Act and its accompanying regulations. Peoples Warehouse had issued warehouse receipts, which by their terms were negotiable and, in compliance with USDA regulations, had stamped the receipts with the conspicuous notation "Negotiable." USDA regulations also specified however that warehouse receipts must state a period, not greater than one year, for which the agricultural product (in this case, cotton) was accepted into storage.⁴⁵ Commercial Bank acquired the warehouse receipts after proper indorsement but one year and three months after the date of issuance. Peoples Warehouse refused to deliver the cotton to Commercial Bank on the ground that Commercial Bank could claim no rights under the receipts because they were stale by three months. The Georgia Court of Appeals held for Commercial Bank through two holdings that illustrate the court's understanding of negotiability for federal warehouse receipts.

First, the court ruled that the terms of the document are what counts for negotiability. In this instance, the terms of the document were terms of negotiability. Thus, the court concluded that the warehouse receipts would have been negotiable even if the stamped notation "Negotiable" required by USDA regulations were not present. Furthermore, the court noted its reassurance as to its interpretation of negotiability under the Act because Georgia law and the Uniform Warehouse Receipts Act also examined the terms of the document itself, not any conspicuous stamped notation, to determine negotiability.⁴⁶ In this regard, because the receipts by their terms were negotiable, the conspicuous stamped notation "Negotiable" only re-emphasized the negotiability of the receipts.

With its first holding, the Georgia Court of Appeals interpreted the Act in a way which is compatible with the concept of negotiability adopted under Article 7. The terms of the document — magic words — control negotiability. Although the Georgia court was a state court interpreting a federal act, the court was delighted to be able to interpret the Act in such a way as to make it compatible with existing state

44. 38 S.E.2d 855 (Ga. Ct. App. 1946).

45. 7 C.F.R. § 736.18(a)(8), (b) (1993) (grain warehouses). The regulations for cotton warehouses no longer contain a one-year duration for cotton warehouse receipts. *Id.* § 735.16(b).

46. *Peoples Warehouse Co. v. Commercial Bank & Trust Co.*, 38 S.E.2d 855, 858-59 (Ga. Ct. App. 1946).

law. Courts today should follow the holding and the attitude of the Georgia Court of Appeals in its *Peoples Warehouse* decision.⁴⁷

Second, the Georgia Court of Appeals held that acquiring the federal warehouse receipt three months after the one-year storage period stated on the receipts did not per se make the receipts non-negotiable or invalid. The court ruled that Peoples Warehouse could not have delivered the cotton to anyone unless it had obtained surrender of the receipts and canceled them on their face. If the warehouse had failed to cancel the receipts, then the court blamed Peoples Warehouse for violating its Section 263 duty under the Act and implicitly held that Peoples Warehouse should suffer any losses caused thereby.⁴⁸ Moreover, the court ruled that in its demurrer Peoples Warehouse presented no factual allegations that Commercial Bank had failed to exercise due care.⁴⁹

With its second holding, the Georgia Court of Appeals provided an interpretation of the concept of negotiability under the Act that is compatible with the concept of due negotiation in U.C.C. section 7-501(4). Section 7-501(4) includes as an element of due negotiation

47. In what should be classified as dictum, the Georgia Court of Appeals did discuss what would happen if a warehouse stamped a receipt "Negotiable" when by its terms the document was non-negotiable. The court stated that due to the stamped notation, the document would be negotiable as against the warehouse "even though as respecting any party to the transaction other than the warehouseman, it might not be negotiable." *Peoples Warehouse Co.*, 38 S.E.2d at 858. The court did not address a further possibility: a stamped notation of "Not Negotiable" upon a document that by its terms is negotiable.

Article 7 of the U.C.C. does not require that any conspicuous stamped notation of "Negotiable" or "Not Negotiable" be placed on documents of title in contrast to the USDA regulations mandating such a conspicuous stamped notation. Thus, between Article 7 and the Act, the possibility exists that negotiability may have a different meaning under the Act due to stamped notations placed on the receipt in compliance with USDA regulations. For federal warehouse receipts, courts must take into account both the terms of the document and the conspicuous stamped notation when defining negotiability.

This potential difference concerning negotiability between federal warehouse receipts and Article 7 warehouse receipts can be nullified in two ways. First, the USDA regulation says that the receipts will be stamped with "[t]he words 'Not Negotiable,' or 'Negotiable,' according to the nature of the receipt." 7 C.F.R. § 736.18(7) (1993) (emphasis added). The emphasized words can be interpreted to mean that the stamped notation is irrelevant when in conflict with the nature (terms) of the receipt itself. Thus, the USDA regulation can be interpreted as adopting the terms-of-the-document definition of negotiability just like U.C.C. § 7-104(1). Second, the stamped notation requirement originates in USDA regulations. The USDA could rewrite the regulations to eliminate this stamped notation requirement. If the USDA eliminated the stamped notation requirement, then negotiability for federal warehouse receipts would be controlled solely by the terms of the document just as is true of Article 7 documents of title.

48. 7 U.S.C. § 263 (1988). Section 263 provides that "[a] warehouseman conducting a warehouse licensed under this chapter shall plainly cancel upon the face thereof each receipt returned to him upon the delivery by him of the agricultural products for which the receipt was issued." *Id.*

49. *Peoples Warehouse Co.*, 38 S.E.2d. at 859.

that the document be taken in the regular course of business or financing. In the Official Comment to section 7-501, the drafters state that irregularities on the face of a document or unexplained staleness "may appropriately be recognized as negating a negotiation in 'regular' course."⁵⁰ In *Peoples Warehouse*, the Georgia Court of Appeals recognized staleness as an element of due negotiation but did not allow the warehouse to avoid its obligations to redeliver under negotiable warehouse receipts simply because the receipts were negotiated three months after the storage period stated on their face.⁵¹

Although some tension exists between the concept of negotiability under the Act and the concept of negotiability under Article 7, the tension does not appear to be significant or severe. Courts can easily interpret the concept of negotiability in compatible ways for both federal warehouse receipts under the Act and documents of title under Article 7.

50. U.C.C. § 7-501 cmt. 1.

51. The Act does not create any time limits on the effectiveness of a warehouse receipt. The requirement that the receipt contain a statement as to the period of storage, not exceeding one year, comes from USDA regulations. 7 C.F.R. § 736.18(a)(8), (b). Uniform Commercial Code Article 7, like the Act, does not contain any time limits on the effectiveness of documents of title.

In light of the USDA regulation requiring the storage period to be stated on the face of warehouse receipts, the possibility exists that negotiable federal warehouse receipts will be declared stale and not negotiated in the regular course of business more often than Article 7 documents of title. There are, however, two ways to make the Act and Article 7 more similar on the regular course of business issue.

First, while section 736.18(a)(8) provides that a holder of a receipt must demand delivery within one year of the date of the receipt, section 736.18(b), in its second sentence, also provides as follows:

Upon demand for issuance of a new receipt, surrender of the old receipt by the lawful holder thereof at or before the expiration of the period specified therein and an offer to satisfy the warehouseman's lien, the warehouseman . . . shall, in the absence of some lawful excuse, issue a new receipt for a further specified period, not exceeding one year.

7 C.F.R. § 736.18(b) (1993).

This second sentence can be interpreted to mean that the one-year time limitation on federal receipts is meant to protect the solvency of federal warehouses by insuring that they receive storage charges at least once a year and is not meant to undermine the negotiability of the receipts themselves. This interpretation is supported by the fact that new receipts must be issued ordinarily as a matter of regular course. This interpretation of the USDA regulation does not raise possible conflicts between the legal treatment of federal warehouse receipts when compared to Article 7 documents of title with respect to the regular course element of due negotiation.

Second, the USDA can rewrite its regulations to eliminate the requirement that warehouse receipts state the storage period for which the receipt is issued. By eliminating the storage period, the USDA would remove any time limits on the effectiveness of federal warehouse receipts because the Act itself imposes no time limits. In fact, the USDA did rewrite the cotton regulations in 1944 to remove any odor of staleness from cotton receipts. Cotton receipts under the rewritten regulation are effective indefinitely until all the cotton evidenced by the receipts has been properly redelivered. 7 C.F.R. § 735.16(b) (1993).

D. WAREHOUSE LIENS

Section 7-209 of the U.C.C. sets forth the statutory language governing warehouse liens. The U.C.C. authorizes two types of warehouse liens. Specific (special) liens exist against presently stored goods as set forth in the first sentence of section 7-209. General (spreading) liens exist for charges incurred with respect to previously stored goods as set forth in the second sentence of section 7-209.⁵² Both specific and general liens are possessory liens. A warehouse can claim these liens only while the warehouse retains possession of debtors' goods, and these liens can be satisfied only against debtors' goods presently in possession.⁵³

With respect to non-negotiable warehouse receipts, specific liens arise as a matter of law without the necessity for any notation about the lien being made on the face of the non-negotiable receipt.⁵⁴ For general liens on goods stored under non-negotiable receipts of title, the second sentence of section 7-209(1) mandates that a notation claiming a general lien must be made on the face of the non-negotiable receipt. Without this notation claiming the general lien, the goods stored under the non-negotiable warehouse receipt cannot be charged with a general lien.⁵⁵

With respect to negotiable warehouse receipts, specific liens arise as a matter of law unless the negotiable receipt has been duly negotiated. If the negotiable receipt has been duly negotiated, then the third sentence of section 7-209(1) limits the specific lien to the rate and charges specified on the face of the negotiable warehouse receipt or, if no notation exists, to a reasonable rate and reasonable charges. In other words, unless the warehouse places information about its fees and charges for the specific lien on the face of negotiable receipts, the warehouse can recover only reasonable fees and charges. Original depositors who received negotiable receipts remain bound by the con-

52. Warehouses can claim general liens only as against goods actually deposited at one time with the warehouse. Warehouses cannot claim a general lien with respect to goods previously handled by the warehouse but never stored by the warehouse. *Marlow v. Rollins Cotton Co.*, 127 B.R. 604 (Bankr. W.D. Tenn. 1991).

53. U.C.C. § 7-209(4); *id.* § 7-209 cmt. 1 (1993). See *Sunflower Compress v. Julien Co.*, 136 B.R. 784, 788-90 (Bankr. W.D. Tenn. 1992).

54. U.C.C. § 7-209(1) comment 1.

55. *Id.* See, e.g., *Plains Cotton Coop. Ass'n v. Julien Co.*, 141 B.R. 359, 368-69 (Bankr. W.D. Tenn. 1992) (holding that the warehouse receipts in failing to comply with U.C.C. § 7-209 did not assert a general lien); *Bluebonnet Warehouse Corp. v. Julien Co.*, 136 B.R. 765, 775-76 (Bankr. W.D. Tenn. 1992) (same); *Sunflower Compress*, 136 B.R. at 788-89 (concluding that the language on the warehouse receipt was inadequate to assert a general lien under § 260(j) of the United States Warehouse Act).

tractual charges between them and the warehouse because the specific lien arises as a matter of law.⁵⁶

With respect to a general lien for goods stored under negotiable warehouse receipts, the faces of the negotiable receipts must give notice that a general lien is claimed.⁵⁷ If negotiable receipts lack the notation claiming a general lien, then no general lien exists against either the depositor or any holder by due negotiation.⁵⁸ If the negotiable receipt contains a notation claiming a general lien, then the warehouse can claim the rate and charges specified in the notation against the depositor or holder by due negotiation. If no specified rate or charges are set forth in the general lien notation, then the warehouse can claim the contractual amounts as against the depositor but can only claim a reasonable amount against the holder to whom the warehouse receipt was duly negotiated.⁵⁹

The types of charges that warehouses can claim through either a specific or a general lien must relate to the storage of the goods. The first sentence of section 7-209(1) enumerates these as charges for storage, transportation, insurance, labor, preservation of the goods, sale of the goods, or other charges in relation to the stored goods. Consequently, if warehouses sell fertilizer, seed, or fuel to farmers, then warehouses cannot try to collect money owed for these purchases by asserting a warehouse lien against the debtor's stored goods.⁶⁰ In order to collect for nonbailment related debts, warehouses will have to use section 7-209(2), which allows warehouses to take security interests against bailors' stored goods.

The legal principles concerning warehouse liens described in the preceding paragraphs control even though section 7-202(2)(i) lists a statement about warehouse liens as an essential term of a warehouse receipt. However, courts should reject any assertion that a warehouse has no warehouse lien because its receipt does not contain this essential term or any other term listed as essential by section 7-202(2). Section 7-202(1) provides that a warehouse receipt need not have any particular form. Section 7-202(2) reinforces subsection (1) by providing that if a warehouse receipt does not have a particular essential term, the warehouse is liable for damages caused by the omission.

56. U.C.C. § 7-209(1) cmt. 1.

57. *Id.* § 7-209(1).

58. *Plains Cotton Coop. Ass'n*, 141 B.R. at 368-69; *Bluebonnet Warehouse Corp.*, 136 B.R. at 775-76; *Sunflower Compress*, 136 B.R. at 788-89.

59. U.C.C. § 7-209(1); *id.* cmt. 1.

60. *See* *Western Cotton Serv. Corp. v. Marlow*, 136 B.R. 743, 752 (Bankr. W.D. Tenn. 1991) (stating that a warehouse lien must relate to the stored goods). *See also*, *Jefferson County Coop Ass'n v. Northeast Kansas Prod. Credit Ass'n*, 73 B.R. 3, 5-6 (D. Kan. 1982) (construing the Kansas warehouse lien, a non-U.C.C. lien, as similarly limited to storage charges and as unavailable for nonbailment related debts).

Consequently, if the warehouse has issued a receipt establishing a bailment relationship, then the warehouse should be entitled to claim a warehouse lien even though the issued receipt does not satisfy all the formal elements of section 7-202(2). Issuance of a formally correct warehouse receipt (i.e., one containing all of the essential terms set forth in section 7-202(2)) should not be a condition precedent for a claim of a warehouse lien.⁶¹

The Act makes two references to warehouse liens. First, section 260(j) requires a statement relating to the claim of a warehouse lien as part of the contents that every receipt shall embody within its terms.⁶² Second, section 262(a) refers to the requirement that a warehouse must redeliver stored agricultural products if the person asking for redelivery (depositor or holder), among other predicates, offers to satisfy the warehouse lien.⁶³ The Act does not have any section comparable to U.C.C. section 7-209.

Section 260 of the Act prescribes the contents of federal warehouse receipts. Section 260 does not contain a clause comparable to U.C.C. section 7-202(1), which states that the warehouse receipt need not be in any particular form.⁶⁴ Thus, section 260(j) could be interpreted to require federal warehouses to claim warehouse liens under § 260(j) expressly on the face of the receipt before such liens exist.

In *Southern Cotton Oil Company v. Merchants' & Citizens' Bank*,⁶⁵ the Supreme Court of Georgia ruled that Merchants' and Citizens' Bank ("Bank") took duly negotiated negotiable warehouse receipts free and clear of any warehouse lien. Southern Cotton Oil Company ("Southern Cotton") claimed liens for fertilizers sold to a farmer and for charges on the farmer's cotton for ginning and storage. The farmer had properly negotiated his receipts to the Bank. The court held that the Bank took the receipts free and clear because a federally licensed warehouse could not claim a warehouse lien unless it indicated such lien on the face of the negotiable receipts.

61. *Marlow v. Universal Warehouse Co.*, 136 B.R. 755, 759 (Bankr. W.D. Tenn. 1991). *Contra*, *In re Celotex*, 134 B.R. 993, 996-97 (Bankr. M.D. Fla. 1991); *In re Charter Co.*, 56 B.R. 91, 94 (Bankr. M.D. Fla. 1985). The author agrees with the *Marlow* decision because it provides a better interpretation of U.C.C. § 7-202.

62. 7 U.S.C. § 260(j) (1988). Section 260(j) is substantially identical in its language to U.C.C. § 7-202(2)(i).

63. 7 U.S.C. § 262(a) (1988). U.C.C. § 7-403(2) similarly imposes a requirement upon depositors or holders to pay the warehouse lien at the time of redelivery of the stored goods. *Cf.* *Schilling v. A.L. Book*, 405 N.E.2d 824 (Ill. App. 3d 1980) (holding that section 262(d) controls the requirements for redelivery).

64. For discussion of the form and contents of federal warehouse receipts, see Part III(a).

65. 176 S.E. 392 (Ga. 1934).

In *Southern Cotton*, the Georgia Supreme Court chose to protect the negotiability of federal warehouse receipts to the detriment of permitting a warehouse lien to arise as a matter of law under the Act. In so holding, the Georgia Supreme Court interpreted the Act in a manner that clearly is at odds with U.C.C. section 7-209. Under section 7-209, the Bank would have been accountable for the reasonable charges related to the stored goods.⁶⁶ However, *Southern Cotton* wanted to have the warehouse lien extended to fertilizer sold to the farmer. This fact makes the case of doubtful authority. Warehouse liens should not extend to any nonbailment related debts.⁶⁷ The Georgia Supreme Court did not indicate the size of the fertilizer claim in comparison to the size of the ginning and storage claims. If the fertilizer claim was substantial, then the outcome may have been correct even though the court could have separated the fertilizer claims from the ginning and storage claims.

Despite the fertilizer claim in *Southern Cotton*, a present-day court could properly hold that the negotiability of negotiable federal warehouse receipts is so important that holders to whom the receipts have been duly negotiated should not be held accountable for unexpected charges through a warehouse lien.⁶⁸ Warehouses possess an easy behavioral response to the Georgia Supreme Court's decision in *Southern Cotton*: simply prepare a standard form warehouse receipt that contains a clause providing that advances have been made or liabilities incurred for various activities relating to the storage of agricultural products. In other words, federal warehouses can comply literally with section 260(j) of the Act.

66. U.C.C. § 7-209(1); *id.* cmt. 1. See *supra* note 56 and accompanying text.

67. See *supra* note 60 and accompanying text.

68. As the Georgia Supreme Court stated that "[i]t is to be presumed that [Southern Cotton] would not have issued the warehouse receipts to [the farmer] with no notations entered thereon of its claims of lien if such claims had not been paid." *Southern Cotton Oil Co. v. Merchants' & Citizens' Bank*, 176 S.E. 392, 394 (Ga. 1934).

The disagreement between the Georgia Supreme Court and the drafters of U.C.C. § 7-209 can be restated as follows. The Georgia Supreme Court believes that holders of duly negotiated warehouse receipts are reasonable in assuming that all storage charges have been paid unless a lien claim is stated on the face of the receipts. The drafters believe that holders of duly negotiated warehouse receipts act reasonably only if they assume that reasonable storage charges are outstanding because even as the receipts are negotiated they represent goods still in storage for which storage charges are accruing. If the drafter's understanding is correct, then holders of duly negotiated warehouse receipts take them with implicit notice that an outstanding claim for unpaid storage fees (the warehouse lien) exists.

In choosing between these two competing assumptions, it may be helpful to ask empirical questions. When do warehouses and their customers usually pay storage and other related fees, at the beginning of the bailment or the end of the bailment? When are warehouses and their customers usually able to determine what is owed for the storage services, at the beginning of the bailment or the end of the bailment?

Whereas section 7-209 expressly recognizes general liens as a valid type of warehouse liens, neither the Act nor its regulations mention general liens. Sections 260 and 262 of the Act refer to warehouse liens without clarifying the type or types of warehouse liens that exist. Consequently, whether general liens, as opposed to special liens, exist under the Act is an open question. In *Sunflower Compress v. Julien Company*,⁶⁹ the United States Bankruptcy Court for the Western District of Tennessee purposefully avoided answering this question. The court assumed that the Act would permit general liens and then imposed upon federal warehouses the same requirements for claiming a general lien through section 260(j) of the Act as exists for state warehouses under the statutory language of U.C.C. section 7-209(1).⁷⁰ With its *Sunflower Compress* holding, the court construed the Act as consistent with the U.C.C. on the issue of general liens.

Section 7-210 of the U.C.C. provides procedures through which a warehouse can enforce its warehouse lien. No comparable provision exists in the Act. Because the Act is silent on this point, the *Rice* preemption standard for the Act⁷¹ apparently means state law controls unless state law conflicts with some federal interest. In the cotton warehouse regulations, the Secretary of Agriculture has explicitly recognized that federal warehouses "may take such action to enforce collection of his charges as is permitted by the laws of the State in which the warehouse is located."⁷² Through this regulation, the Secretary has made clear that from the regulator's perspective, no federal interest conflicts with using section 7-210 procedures for the enforcement of federal warehouse liens. Thus, the Act and Article 7 are compatible on the enforcement of warehouse liens.

In reviewing how the Act and Article 7 treat warehouse liens, apparent incompatibilities concerning the creation of liens and the existence of general liens exist between the Act and U.C.C. section 7-209. Even in these two areas of apparent incompatibility however courts today can construe the Act to make it congruent with section 7-209(1). These apparent incompatibilities should be viewed as potential, rather than as actual, conflicts between the Act and Article 7.

E. STANDARD OF CARE

Section 7-204 of the U.C.C. sets forth a standard of reasonable care for warehouses in the storage of goods. This standard of care is

69. 136 B.R. 784 (Bankr. W.D. Tenn. 1992).

70. *Sunflower Compress*, 136 B.R. at 788. For a discussion of claiming a general lien under U.C.C. § 7-209(1), see *supra* notes 57-59 and accompanying text.

71. See *supra* Part II.

72. 7 C.F.R. § 735.29 (1993).

meant to be the minimum standard of care. In the official comment to U.C.C. section 7-101, the drafters expressly disclaim any attempt to define the tort liability of bailees in Article 7.⁷³ Section 7-204(4) reinforces this minimalist approach to bailee liability by expressly permitting states to list other bailment laws that section 7-204 does not impair or repeal.

Section 7-403(1)(b) of the U.C.C. imposes upon warehouses an obligation to redeliver stored goods. If the bailee fails to redeliver, then the bailee is accountable unless the bailee establishes that failure to redeliver was for reasons for which the bailee is not liable under applicable state law. Section 7-403(1)(b) also allows states to adopt an optional clause that places the ultimate burden of persuasion upon the person claiming under the document (usually the bailor). As the note to section 7-403(1)(b) provides, the drafters felt that the ultimate burden of persuasion could be upon either the bailor or the bailee without undermining the principle of uniformity. These provisions in section 7-403 amount to nothing more than a cross-reference to court-made tort law as the source for determining the appropriate standards of liability for warehouses.⁷⁴ In other words, the drafters included language in Article 7 relating to the obligation to redeliver but then purposefully chose the common law as controlling.

When sections 7-204 and 7-403 are considered together, it becomes clear that Article 7 is intentionally a peripheral source of law when issues about the standard of care and the liability of warehouses arise.⁷⁵ Issues concerning the standard of care and warehouse liabil-

73. U.C.C. § 7-101. The official comment provides:

The Article does not attempt to define the tort liability of bailees, except to hold certain classes of bailees to a minimum standard of reasonable care. For important classes of bailees, liabilities in case of loss, damage or destruction, as well as other legal questions associated with particular documents of title, are governed by federal statutes, international treaties, and in some cases regulatory state laws, which supersede the provisions of this Article in case of inconsistency. See Section 7-103.

U.C.C. § 7-101 cmt.

74. U.C.C. § 7-403(1)(b) cmt. 3.

75. The author intends to include within the issues of standard of care and liability the legal questions relating to contributory negligence, damages, and limitations on damages. Article 7 of the U.C.C. is relatively peripheral to these legal questions. See, e.g., *Fugate v. Brockway, Inc.*, 937 F.2d 960, 964-65 (4th Cir. 1991) (holding that the depositor of bottles was not barred by contributory negligence); *In re SLT Warehouse Co.*, 130 B.R. 79, 81, 83 (Bankr. E.D. Mo. 1991) (allowing warehousemen to limit liability by giving effect to a limitation on liability agreement); *Georgia Ports Auth. v. Servac Int'l*, 415 S.E.2d 516, 519 (Ga. Ct. App. 1992) (holding that a warehouseman's liability is not limited to the goods represented by the warehouse receipt but to any loss reasonably foreseeable).

ity are governed by the common law method of judicial decision in a case-by-case adjudication.⁷⁶

The Act contains no provisions comparable to U.C.C. sections 7-204 and 7-403. The Act does not address the standard of care and the tort liability of federal warehouses. In the regulations, however, the Secretary of Agriculture adopts a "reasonably careful owner" standard as the standard of care for federally licensed warehouses.⁷⁷ This regulatory standard reads like the minimal standard that U.C.C. section 7-204 also adopts.⁷⁸

In *United States v. Cloverleaf Cold Storage Company*,⁷⁹ the United States District Court for the Northern District of Iowa ruled on a summary judgment motion in which Cloverleaf Cold Storage ("Cloverleaf") attempted to defeat a claim by the United States for contamination to butter that the government had stored with the warehouse. Cloverleaf argued that the United States pled no allegation of negligence. In response, the court interpreted the Act to adopt the majority rule from the common law of bailments, which it characterized as giving the "bailor the benefit of a presumption of fault which shifts the burden of going forward with the evidence of due care to the bailee."⁸⁰ In dicta, the court additionally interpreted the Act to adopt also the majority rule from the common law of bailments with respect to the ultimate burden of persuasion.⁸¹ Moreover, the court stated that the majority rule from the common law, the federal rule under the Act, and U.C.C. section 7-403(1)(b) were all consistent on these issues.⁸²

Whether the Iowa District Court, in *Cloverleaf Cold Storage Company*, correctly understood the majority rules from the common law of bailments is open to debate.⁸³ What is not debatable however is that the court interpreted the Act and Article 7 as consistent. Courts are likely to interpret the Act as adopting the common law of bailments on

76. For an excellent discussion of these issues, see Helmholz, *Bailment Theories and the Liability of Bailees: The Elusive Uniform Standard of Reasonable Care*, 41 KAN. L. REV. 97 (1992). Professor Helmholz's article demonstrates how peripheral Article 7 is to these issues by the fact that he never cites a single provision from it. Indeed, Professor Helmholz refers only once to the U.C.C. as an existent document and this passing reference occurs on the 35th page of the 38-page article.

77. 7 C.F.R. § 736.40 (1993).

78. See *supra* note 73 and accompanying text.

79. 286 F. Supp. 680 (N.D. Iowa 1968).

80. *United States v. Cloverleaf Cold Storage Co.*, 286 F. Supp. 680, 681 (N.D. Iowa 1968).

81. *Id.* at 682. The court understood the majority rule to be that the ultimate burden of persuasion rests with the bailor. *Id.*

82. *Cloverleaf Cold Storage Co.*, 286 F. Supp. at 682.

83. See *Commodities Reserve Corp. v. Belt's Wharf Warehouses, Inc.*, 529 A.2d 822, 828 (Md. 1987) (stating that if the bailee possesses a document of title the burden of persuasion rest with the bailor).

standard of care and warehouse liability issues just as the drafters of Article 7 adopted the common law of bailments to resolve these issues.

F. PRIORITY

True priority disputes arise when two competing parties to goods each assert a valid claim to the goods.⁸⁴ Courts face true priority disputes when they must decide which of two valid claims has priority to the goods. In the common parlance of commercial lawyers, courts must decide which claim trumps the other valid claim(s). With respect to disputes to goods covered by warehouse receipts, there are three distinct true priority dispute scenarios that need to be discussed separately.

1. *Depositor versus Depositor*

Assume that Farmer A and Farmer B both deposited fungible grain⁸⁵ in a warehouse and received a warehouse receipt in return. When both Farmer A and Farmer B returned at the same instant to ask for redelivery of their grain, the warehouse had a shortage. Between Farmer A and Farmer B, whose valid claim to redelivery has priority?

Section 7-207(2) of the U.C.C. clearly settles this priority dispute by providing that "[f]ungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner for that owner's share."⁸⁶ In other words, section 7-207(2) settles the priority dispute between Farmer A and Farmer B by decreeing that each farmer is entitled to a pro rata share of the grain remaining in storage. Neither the valid claim of Farmer A nor the valid claim of Farmer B gains priority over the other.⁸⁷

84. When competing parties assert claims against goods, Party A can defeat Party B by proving that Party B does not have a valid claim to the goods. While this issue of the validity of a claim is often raised in cases involving true priority disputes, validity-of-claim disputes are not themselves true priority disputes.

85. Fungible grain must be distinguished from identity-preserved grain. Identity-preserved grain is owned by the depositor to whom the grain is identified. There cannot be a depositor versus depositor true priority dispute as to identity-preserved grain. One party owns the grain and the other party does not. Although determining who is the owner may be a difficult legal dispute, ownership is a validity-of-claim dispute, and not a priority dispute. *Cf. State ex rel. Crawford v. Centerville Grain Co.*, 618 P.2d 1206, 1212 (Kan. Ct. App. 1980) (discussing the pro rata distribution of funds available to grain lien creditors).

86. U.C.C. § 7-207(2).

87. The second sentence of U.C.C. § 7-207(2) makes all holders to whom overissued receipts have been duly negotiated persons entitled to claim a pro rata share of the fungible goods remaining in storage. Thus, if Farmer A had duly negotiated negotiable warehouse receipts to Lender C or Buyer D, Lender C or Buyer D would also share pro rata with Farmer B.

The Act does not contain language which as clearly settles the priority dispute between Farmer A and Farmer B. However, section 258 of the Act provides:

[A] warehouseman may mingle fungible agricultural products with other agricultural products of the same kind and grade, and shall be severally liable to each depositor for the care and redelivery of his share of such mass, to the same extent and under the same circumstances as if the agricultural products had been kept separate.⁸⁸

In light of the statutory language of section 258, which provides that warehouses are severally liable to each depositor for his share of mingled fungible grain, courts resolving depositor versus depositor priority disputes can easily conclude that each depositor shares pro rata in the remaining grain when a shortage exists.

The author has found no cases construing section 258 of the Act in a depositor versus depositor priority dispute. However, in an early case establishing the pro rata share principle, the United States Court of Appeals for the Tenth Circuit in *United States v. Luther*⁸⁹ bound the Commodity Credit Corporation, a corporation wholly owned by the United States government, to its pro rata share in a priority dispute case under Kansas warehouse law. If the Tenth Circuit was unwilling to give a federal corporation more than its pro rata share in a state licensed warehouse, then courts will assuredly limit depositors to their pro rata shares when a shortage exists in federally licensed warehouses. Thus, the Act and U.C.C. section 7-207 reach the same result in true priority disputes between depositors.

2. Warehouse Lien versus a Claimant to the Stored Goods

If the claimant is the original depositor or if the claimant acquired its claim after the depositor placed the goods into storage, then neither Article 7 nor the Act specifically address how to resolve a dispute between warehouse liens and these claimants.⁹⁰ If the warehouse has properly asserted either a special lien or a general lien,

88. 7 U.S.C. § 258 (1988).

89. 225 F.2d 499 (10th Cir. 1955).

90. It could be argued that U.C.C. § 7-209(3) and the accompanying official comments specifically address the priority dispute between a warehouse lien and the original depositor or a claimant against the goods after storage. However, perhaps section 7-209(3) was not meant to cover this factual pattern. The author believes that section 7-209(3) was meant to cover a factual pattern shortly to be discussed in the text. See *infra* notes 95-96 and accompanying text.

The author also opines that even if section 7-209(3) were interpreted to apply to this precise factual situation, results should not differ from the solutions offered in the text. Furthermore, U.C.C. § 7-209(1) and official Comment 1 appear to be more relevant than U.C.C. § 7-209(3). In the author's opinion, section 7-209(1) and official Comment 1 support the solutions offered in the text.

then the warehouses should prevail. The original depositor should not be able to obtain return of the goods without paying the warehouse storage charges because of the contract between the warehouse and the depositor.⁹¹ The transferee of either a non-negotiable warehouse receipt or a negotiable warehouse receipt not duly negotiated has no better claim to the goods than the original depositor.⁹² Thus, if the depositor cannot obtain redelivery without paying the storage costs, the transferee similarly must pay the warehouse lien before getting the goods. If the claimant is a holder of a negotiable warehouse receipt duly negotiated, then this claimant should have to pay the warehouse lien before acquiring the goods because a valid warehouse lien prevents the claimant from being a holder in due course with respect to the warehouse lien itself. The warehouse lien either arises as a matter of law or is explicitly set forth on the face of the negotiable warehouse receipt. In this author's opinion, there is no true priority dispute possible between warehouse liens and the original depositor or claimants against the goods after their storage. The correct issue in these disputes is whether the warehouse has properly asserted a warehouse lien. If the warehouse has properly asserted a warehouse lien, then the warehouse prevails and gets paid its charges before it must redeliver the goods.⁹³ This should be true under both the Article 7 and the Act.

Now assume that the a secured party acquired a security interest against the goods before the goods were placed in storage. Further assume that the warehouse refuses to deliver the goods to the secured party, who validly forecloses on the goods⁹⁴ or possesses the debtor's negotiable warehouse receipts, until the secured party pays the warehouse charges. Which has priority in this fact pattern, the security interest or the warehouse lien?

Despite U.C.C. section 7-403, which implies that warehouses have to deliver goods only after the person claiming them has satisfied the warehouse lien,⁹⁵ U.C.C. section 7-209(3)(a) actually governs this priority dispute. If the secured party entrusted the goods to the bailor in a way that gave the bailor authority to pledge them to a good faith purchaser, then the secured party loses to the warehouse. However, if the secured party did not entrust the goods to the bailor, then the se-

91. U.C.C. § 7-403(2). Section 7-403(2) provides that "[a] person claiming goods covered by a document of title must satisfy the bailee's lien where the bailee so requests or where the bailee is prohibited by law from delivering the goods until the charges are paid." *Id.*

92. U.C.C. § 7-504(1).

93. For discussion of when and how warehouses obtain warehouse liens, see *supra* Part III(d).

94. *Cf.* U.C.C. § 7-602.

95. U.C.C. § 7-403(1), (2); *id.* § 7-402(2) cmt. 4.

cured party's interest trumps the warehouse's lien. Thus, section 7-209(3)(a) uses the concept of entrustment to determine priority between these two valid claims.⁹⁶

In contrast to section 7-209(3)(a), the Act does not use the concept of entrustment. However, the Act does state in section 262 that federally licensed warehouses shall deliver stored agricultural products upon demand of receipt holders if the demand is accompanied by an offer to satisfy the warehouse lien.⁹⁷ In addition, the Secretary of Agriculture has shown concern for the financial strength of warehouses by limiting federal warehouse receipts to a period not to exceed one year. A depositor can obtain a new replacement receipt by surrendering the old receipt and paying the warehouse charges incurred during the period the old receipt was outstanding.⁹⁸ Thus, courts could interpret section 262 of the Act to forbid redelivery by warehouses in all circumstances unless the warehouse lien was paid.⁹⁹ If courts adopted this interpretation of section 262, they could also be implying that warehouse liens have priority over security interests taken against goods prior to their storage. Alternatively, courts could introduce the concept of entrustment into section 262 and distinguish between who must pay the warehouse lien before redelivery (entrusters) and who can get redelivery without paying the warehouse lien (nonentrusters).

At present, the interpretation of section 262 is unclear. It is also unclear whether section 262 and U.C.C. section 7-209(3)(a) are compatible on the issue of priority between warehouse liens and security interests taken against goods prior to their storage. On this priority issue, the potential for conflict between the Act and Article 7 exists.

96. For cases discussing the concept of entrustment as used in U.C.C. § 7-209(3)(a), see *In re Siena Publishers Assoc.*, 149 B.R. 359, 365 (Bankr. S.D. N.Y. 1993) (noting how entrustment can effectively negate a secured party's priority); *Curry Grain Storage, Inc. v. Hesston Corp.*, 815 P.2d 1068, 1071-72 (Idaho 1991) (discussing what constitutes entrustment); *K. Furniture Co. v. Sanders Transfer & Storage Co., Inc.*, 532 S.W.2d 910, 911 (Tenn. 1975) (discussing the relationship between entrustment and priority).

The warehouse lien does not have automatic priority under U.C.C. § 9-310 (as a statutory possessory lien) because the lien's statutory language expressly provides that the lien is subordinate in nonentrustment situations. U.C.C. § 7-209(3)(a) cmt. 3 (1993). Thus, courts must distinguish between entrustment and nonentrustment situations to determine which has priority between a warehouse lien and a security interest acquired prior to the storage of the goods.

97. 7 U.S.C. § 262 (1988). The language of section 262 that demand for redelivery be accompanied by payment of the warehouse lien is reiterated by the regulations. 7 C.F.R. § 736.48 (1993). *Cf. Schilling v. A. L. Book*, 405 N.E.2d 824, 827-28 (Ill. App. Ct. 1980) (stating that a failure to deliver stored goods before return of negotiable receipt does not constitute a refusal).

98. 7 C.F.R. § 736.18(b) (1993).

99. *Cf. U.C.C. § 7-403(2) cmt. 2* (1993). The comment indicates that the warehouse laws of some jurisdictions, without identifying which jurisdictions, forbid redelivery without payment of the warehouse lien.

3. Buyer/Secured Party versus Secured Party

When discussing priority under Article 7 between a buyer/secured party and another secured party,¹⁰⁰ it is first necessary to distinguish non-negotiable warehouse receipts from negotiable warehouse receipts.

Non-negotiable warehouse receipts are documents that evidence the storage transaction, but non-negotiable warehouse receipts do not represent the stored goods. The existence of non-negotiable warehouse receipts is irrelevant to determining priority between a buyer/secured party and another secured party when each makes a valid claim to the goods. Priority between a buyer/secured party of the goods and another secured party is settled by the usual priority rules of both U.C.C. Article 9¹⁰¹ and Article 7.¹⁰²

In contrast to non-negotiable warehouse receipts, negotiable warehouse receipts embody the goods for which the receipt exist. Negotiable warehouse receipts represent the goods so that once the receipt exists the parties to the storage transaction thereafter deal with the goods as reified in the negotiable warehouse receipt. Parties to negotiable warehouse receipt transactions do not deal in goods; they deal in negotiable documents.¹⁰³ The U.C.C. acknowledges the reification of negotiable warehouse receipts and its impact upon priority disputes primarily in sections 7-501, 7-502, 7-503, 9-304, 9-305, and 9-309. Applying these provisions to priority disputes between buyers/secured parties and other secured parties gives rise to several solutions.

If the priority dispute arose after negotiable warehouse receipts reified the goods, then the claimant who possesses the negotiable warehouse receipts and received them into possession by due negotiation prevails.¹⁰⁴ Three examples provide clarification:

Example One. Farmer holds negotiable warehouse receipts and uses them as security for a loan from Bank A. Bank A takes possession of the negotiable warehouse receipts through due negotiation.

100. Warehouses can become a secured party. U.C.C. § 7-209(2). As a secured party, the discussion in the text applies to warehouses.

101. For the comments in the text, the most relevant provisions of U.C.C. Article 9 are sections 9-304(3), 9-305, 9-306, 9-307 and 9-312. Parties to transactions in goods for which non-negotiable warehouse receipts exist must also always consider the clear title section of the Food Security Act of 1985, codified at 7 U.S.C. § 1631.

102. For the comments in the text, the most relevant provision of U.C.C. Article 7 is section 7-504.

103. For a concise overview of this reification of goods by negotiable warehouse receipts, see John F. Dolan, *Changing Commercial Practices and the Uniform Commercial Code*, 26 *Lox. L.A. L. Rev.* 579, 589-92 (1993).

104. See *Scallop Petroleum Co. v. Banque Trad-Credit Lyonnais France S.A.*, 690 F. Supp. 184 (S.D.N.Y. 1988).

Farmer then goes to Bank B to get a second loan on the crop represented by the negotiable warehouse receipts. Bank B must deal with the crop through the negotiable warehouse receipts. Therefore, Bank B cannot gain priority over Bank A for any Bank B loan unless Bank A duly negotiates the negotiable warehouse receipts to Bank B.¹⁰⁵

Example Two. Farmer gets a loan from Bank A using negotiable warehouse receipts as collateral. Bank A took a security interest against the negotiable warehouse receipts by filing against them.¹⁰⁶ Bank A left the negotiable warehouse receipts in Farmer's possession. Later, Farmer duly negotiates the negotiable warehouse receipts to Bank B for a loan, and Bank B takes possession of them. In this situation, Bank B has priority over Bank A because Bank B is the claimant with possession and received them into possession by due negotiation.¹⁰⁷

Example Three. Farmer uses his growing wheat as collateral for a loan from Bank A. Bank A properly acquires a perfected security interest against the growing crop and its harvested product. Once harvested, Farmer stores the wheat in an elevator under a negotiable warehouse receipt. Farmer then takes the negotiable warehouse receipt to Bank B for a second loan. Farmer duly negotiates the negotiable warehouse receipts to Bank B. Who has priority: Bank A's valid claim against the crop as goods or Bank B's valid claim against the negotiable warehouse receipts as documents of title?

The U.C.C. provides a solution to this priority dispute in sections 7-501, 7-502, and 7-503.¹⁰⁸ Applying section 7-503 subsection (1) protects the paramount (first in time) rights of Bank A if Bank A did not entrust or acquiesce in Farmer obtaining and putting the negotiable warehouse receipt into the flow of commerce. Official Comment 1 to section 7-503 makes clear that entrustment and acquiescence are easily found because the Code chooses to protect negotiability and the smooth flow of commerce. To restate the solutions of section 7-503(1), Bank A wins because of its security interest in goods if Bank A did not entrust or acquiesce; Bank B wins because of its security interest in

105. U.C.C. §§ 9-305, 9-309, 7-501, 7-502. Bank A would duly negotiate the negotiable warehouse receipts to Bank B only if Bank A meant to subordinate its security interest to the security interest of Bank B. If Bank A does not duly negotiate to Bank B, Bank B knows that its claim against the negotiable warehouse receipts is inferior to Bank A's claim. Bank B knows that if it makes the loan to Farmer that its loan has second priority.

106. U.C.C. § 9-304(1).

107. *Id.* §§ 9-309, 7-501, 7-502. By its actions, Bank A left itself open to double dealing by Farmer.

108. Uniform Commercial Code § 9-309 does not provide a solution to this priority dispute. Section 9-309 simply provides a cross-reference to Article 7 and its sections cited in the text where the solution is found.

the negotiable warehouse receipts if Bank A did entrust or acquiesce. The litigated cases focus on the factual and legal dispute about what actions of Bank A constituted entrustment and acquiescence.¹⁰⁹

The Act has no provisions directly comparable to U.C.C. sections 7-501, 7-502, 7-503, 7-504, 9-304, 9-305, 9-309, and 9-312. The Act does not address the resolution of priority disputes between buyers/secured parties and another secured party. The Act only addresses priority disputes in section 259(c)(2)(B), which deals with voluntarily used electronic cotton warehouse receipts.¹¹⁰ Section 259(c)(2)(B) provides that "[i]f more than one security interest exists in the cotton reflected on the electronic warehouse receipt, the priority of the security interests shall be determined by the applicable Federal or State law."¹¹¹ As there is no applicable federal law determining priority, section 259(c)(2)(B) seemingly adopts state law as the content of federal law for determining priority with respect to competing claims on electronic cotton warehouse receipts. State law in this context is U.C.C. Articles 9 and 7. In light of the explicit language of section 259 and the previously discussed preemptions standards,¹¹² the United States Supreme Court has articulated in *Rice v. Santa Fe Elevator Corp.*¹¹³ and *United States v. Kimbell Foods, Inc.*,¹¹⁴ one can conclude that courts dealing with priority disputes between buyers/secured parties and other secured parties under the Act would adopt the U.C.C. solutions as the content of federal law regardless of the type of commodity covered by the warehouse receipt.

While courts are likely to adopt the U.C.C. solutions to priority disputes, potential tension between the Act and the U.C.C. might arise with respect to Example Three. Courts might interpret the Act

109. See, e.g., *In re R.V. Segars, Co.*, 54 B.R. 170, 171-74 (Bankr. D.S.C. 1985) (holding that allowing farmer to store goods and receive negotiable receipts constituted acquiescence); *In re Jamestown Farmers Elevator, Inc.*, 49 B.R. 661, 662-63 (Bankr. D.N.D. 1985) (noting that acknowledgement of another's claim to goods may constitute acquiescence); *United States v. Hext*, 444 F.2d 804, 812-14 (5th Cir. 1971) (concluding that an FmHA security interest terminated when the FmHA allowed farmer to gin and sell his cotton).

110. In 1990, Congress authorized the Secretary of Agriculture to create a central filing system for electronic cotton warehouse receipts from federally licensed cotton warehouses. No cotton warehouse was required to acquire the electronic technology. However, cotton warehouses with the electronic technology could use the central filing system in lieu of issuing a paper cotton warehouse receipt. 104 Stat. 3441 (1990). In 1992, Congress amended the authorization to create a central filing system for electronic cotton warehouse receipts. Congress broadened the scope of the Secretary's authority so that the central filing system could include electronic cotton warehouse receipts from state-licensed warehouses also. 106 Stat. 4140 (1992).

111. 7 U.S.C. § 259(c)(2)(B) (1988 & Supp. 1993).

112. See *supra* Part II.

113. 331 U.S. 218 (1947).

114. 440 U.S. 715 (1979).

to be more protective of negotiability for negotiable federal warehouse receipts than the U.C.C. is of negotiable warehouse receipts under section 7-503(1). Courts could provide this greater protection by refusing to distinguish between factual situations through the concepts of entrustment and acquiescence. Courts could hold that the Act should be interpreted to always give priority to Bank B in Example Three regardless of the actions of entrustment or acquiescence by Bank A because the negotiability of negotiable federal warehouse receipts should not be undermined by recognition of paramount rights in others.¹¹⁵ At present, the likely interpretation of the Act and its relationship to the concepts of entrustment and acquiescence is unclear. Thus, whether this potential tension will develop into an actual incompatibility between the Act and U.C.C. section 7-503(1) is not known.

While section 259 of the Act does not directly resolve priority disputes between buyers/secured parties and other secured parties, section 259 has another facet which greatly affects priority disputes. Under section 259(c)(2), the Secretary of Agriculture can record in the central filing system for electronic cotton warehouse receipts the possessory interests of persons in cotton.¹¹⁶ The recording of possessory interests in the central filing system appears to raise four implications:

First, if a person records a valid possessory interest in cotton in the system, then the person is considered to be in possession of the warehouse receipt and to have a perfected security interest in the electronic warehouse receipt.¹¹⁷ Second, any person who later buys or takes a security interest against the electronic cotton warehouse receipt will see on the face of the electronic receipt the possessory interest and the possession of prior claimant(s). Third, a later person who sees on the face of the electronic warehouse receipt these possessory claims takes the electronic receipt with notice of them. Therefore, as to the recorded possessory interest(s), the later person does not qualify

115. In the *Rice* decision, the United States Supreme Court provided a brief glimpse of the legislative history to the 1931 amendments to the United States Warehouse Act, which implied that protecting the negotiability of federal negotiable warehouse receipts was the primary reason for the amendments. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 223 n.4 (1947).

Courts might still worry about thieves (embezzlers and forgers) introducing negotiable federal warehouse receipts into the stream of commerce. The U.C.C. uses the concepts of entrustment and acquiescence to protect holders of negotiable warehouse receipts from the actions of thieves. See U.C.C. § 7-501(1) cmt. Courts interpreting the Act might find other concepts aside from entrustment and acquiescence to provide the same protection against thieves.

116. Final regulations implementing 7 U.S.C. § 259(c) do not yet exist. Proposed regulations can be found at 58 Fed. Reg. 43298 (1993) (proposed Aug. 16, 1993).

117. 7 U.S.C. § 259(c)(2)(B) (1988 & Supp. 1993).

as a holder to whom a negotiable electronic warehouse receipt has been duly negotiated. Fourth, if the later person cannot qualify as a holder by due negotiation, then the later person takes the electronic cotton warehouse receipt subject to the prior recorded possessory interest(s).

Section 259 of the Act does not change the concept of negotiability for electronic cotton warehouse receipts, but it does change the mechanics and information upon which the concept of negotiability operates. As a matter of law, section 259 is entirely compatible with Article 7. As a matter of practicality, section 259 resolves the priority dispute between buyers/secured parties and another secured party by an entirely different approach.¹¹⁸

Section 259 resolves the priority dispute through the concept of due negotiation.¹¹⁹ By providing recorded information about prior claims against negotiable warehouse receipts, the central filing system created under the authority of section 259 works to prevent priority disputes. Later buyers/secured parties will have information available to them at the time of the transaction that permits them to decide what steps, if any, they desire to take before purchasing or lending.

If the central filing system for electronic cotton warehouse receipts gains widespread acceptance, then the Act and Article 7 will diverge significantly in the handling of Example Three priority disputes. The Act and Article 7 will diverge not because courts interpret their statutory language in incompatible ways, but because courts will use due negotiation to settle Example Three priority disputes under the Act and use entrustment and acquiescence under Article 7. Moreover, if the central filing system works well for electronic cotton warehouse receipts, then the Act may be extended to electronic warehouse receipts for all types of agricultural commodities. If the Act is extended to electronic warehouse receipts for all types of agricultural commodities, then the coverage and importance provided by Article 7 for the resolution of priority disputes between buyers/secured parties and other secured parties with respect to warehouse receipts issued by

118. In the regulations governing grain warehouse receipts, the Secretary has long had a provision providing that "[e]very negotiable receipt issued shall . . . embody within its written or printed terms, a form of indorsement which may be used by the depositor, or his authorized agent, for showing the ownership of, and liens, mortgages, or other encumbrances on the grain covered by the receipt." 7 C.F.R. § 736.18(c) (1993).

The use of this indorsement segment of negotiable grain warehouse receipts to record liens, mortgages, and other encumbrances on the negotiable federal warehouse receipt has been minimal. If the indorsement segment had been regularly used, its implications are the same for paper federal warehouse receipts as those being discussed in the text for electronic warehouse receipts.

119. *Cf.* U.C.C. § 7-501(4) (outlining the elements of due negotiation).

federally licensed warehouses will be greatly reduced. Under the *Rice* preemption standard, the Act will subsume Article 7.

The comments in the preceding paragraph apply only to electronic cotton warehouse receipts issued by federally licensed warehouses. No other agricultural commodities can presently be embodied in electronic warehouse receipts. While Congress permitted state-licensed cotton warehouses to use the electronic warehouse receipt system being created by the Secretary of Agriculture,¹²⁰ Congress probably intended for these state-licensed electronic cotton warehouse receipts to continue to be governed by state law. In other words, state-licensed cotton warehouses can use the federal system to issue electronic warehouse receipts, but the warehouse receipt itself is still governed by Article 7 and by state warehouse laws for all other purposes,¹²¹ except one. The sole exception is found in the express language of section 259(c)(2)(B), which states that "for the purpose of perfecting the security interest of the person under Federal or State law with respect to

120. 7 U.S.C. § 259(c)(1)(A) (1988 & Supp. 1993).

121. In issuing its Proposed Rule on electronic warehouse receipts, the Secretary of Agriculture wrote:

The proposed rule would also allow providers licensed by the Secretary to accept electronic warehouse receipts from warehousemen not licensed by the Secretary. However, the Secretary, under this proposed rule, would not regulate or take any responsibility for such warehousemen, the cotton stored in their warehouses, the content of warehouse receipts issued by such warehousemen, or the manner in which such warehouse receipts are issued. Such matters would be governed by the applicable State law.

58 Fed. Reg. 43299 (Aug. 16, 1993).

The Secretary's interpretation is a reasonable interpretation of what Congress intended when it adopted the 1992 amendments to the Act. The Secretary's interpretation is particularly important because the last sentence of 7 U.S.C. § 259(c)(2)(B), which originated in the 1992 amendments, provides that "[t]his subsection is applicable to electronic cotton warehouse receipts and any other security interests covering cotton stored in a cotton warehouse, regardless of whether the warehouse is licensed under this Act." It is a fair reading of the language of this last sentence to conclude that Congress thereby took control of all electronic cotton warehouse receipts in 1992. If this congressional intent to control all electronic receipts were adopted, then under the preemption standard for the Act from *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947), the Act would preempt Article 7 state law. The Act alone would govern electronic warehouse receipts for those who voluntarily use the Secretary of Agriculture's electronic filing system.

Congressional action in 1992 provides no clues as to Congress' intent with regard to the 1992 amendments. There were no Committee hearings and no Committee reports on the 1992 amendments. Furthermore, the 1992 amendments sailed through both the House and the Senate without a single word of discussion. 138 CONG. REC. H11261-H11262 (Oct. 4, 1992); 138 CONG. REC. S17156 (Oct. 7, 1992). Without any legislative history, the Secretary's interpretation should be honored. This is particularly true because the Licensing Authority Division, Agricultural Stabilization and Conservation Service, United States Department of Agriculture wrote and promoted the 1992 amendments. Telephone Interview with Mr. Steve Mikkelsen, Licensing Authority Division, ASCS, USDA (Aug. 17, 1993). The same USDA agency wrote the Proposed Rule referred to in the first paragraph of this footnote.

the cotton covered by the warehouse receipt, [the holder shall] be considered to be in possession of the warehouse receipt.¹²² With this explicit language, federal law controls as to the meaning of possession of an electronic cotton warehouse receipt even for electronic cotton warehouse receipts issued by state-licensed cotton warehouses.

If the future of warehouse receipts and documents of title is electronic commerce, then the experiences gained under the central filing system authorized in section 259 of the Act should serve as a pattern for Article 7. If this were to occur, Article 7 would not necessarily change conceptually, but it would change functionally in order to accommodate new technology. After all, the U.C.C. is meant to reflect changing business practices, not static legal constructs.¹²³

G. MISSING RECEIPTS

Sections 7-402 and 7-601 of the U.C.C. deal with lost, stolen, and destroyed documents and duplicates issued as replacements. Under section 7-402, the U.C.C. adopts the basic rule that holders of duplicate documents gain no rights in the goods except when the duplicate documents are substitutes for lost, stolen, or destroyed documents. Section 7-402 further provides that issuers of the duplicates are liable for damages caused by the failure to identify duplicate documents with a conspicuous notation on the face of the document. Section 7-601 of the U.C.C. details how warehouses should respond to claims that documents have been lost, stolen, or destroyed. Section 7-601 describes two procedures.

The first procedure under section 7-601(1) is a safe harbor for warehouses by allowing them to seek an order from a court to issue duplicate documents or to make delivery without surrender of the original documents.¹²⁴ If warehouses seek a court order, then warehouses have no liability to any person and may even recover reasonable costs and attorney fees for bringing the action. Section 7-601(1) also distinguishes between negotiable and non-negotiable documents. If the original documents were negotiable, then courts must require those receiving duplicates or the goods, without surrendering the originals, to post security (such as a bond) to indemnify anyone who suffers loss as a result of the original, nonsurrendered negotiable document. If the original documents were non-negotiable, then courts have discretion to require security from those receiving the duplicates

122. 7 U.S.C. § 259(c)(2)(B) (1988 & Supp. 1993).

123. John F. Dolan, *Changing Commercial Practices and the Uniform Commercial Code*, 26 Loy. L.A. L. Rev. 579 (1993).

124. U.C.C. § 7-601(2) cmt. 2.

or the goods, especially if the court has concerns that the original documents may in fact have been negotiable.¹²⁵

The second procedure under section 7-601(2) permits warehouses to make redelivery of goods to persons claiming under lost, stolen, or destroyed negotiable documents without a court order.¹²⁶ Warehouses may do so however only under the condition that they accept the risk of liability for actual damages of redelivery without demanding surrender of the original negotiable documents.¹²⁷ Warehouses also are liable for conversion if they make redelivery in bad faith or in good faith without requiring those receiving the goods (who did not surrender the original negotiable documents) to post security in an amount at least double the value of the goods redelivered.¹²⁸ In other words, under section 7-601(2), warehouses can redeliver whenever they so desire and without restrictions or requirements to someone claiming their original documents were lost, stolen, or destroyed. When warehouses do so, however, they risk significant liability.

The Act addresses lost or destroyed warehouse receipts in section 261.¹²⁹ Section 261 gains concrete clarity in its implementing regulation. This regulatory section imposes upon warehouses that are being asked to issue duplicate receipts for original negotiable warehouse receipts¹³⁰ standards that are similar to those set forth in U.C.C. sec-

125. *Id.* § 7-601 cmt. 3.

126. *Id.* § 7-601(2) cmt. 1.

127. *Id.* § 7-601(2) General Revision cmt.

128. *Id.* § 7-601(2) cmt. 5.

129. Unlike U.C.C. sections 7-402 and 7-601, neither section 261 nor its implementing regulation, 7 C.F.R. § 736.21, refer to stolen documents. It is unclear whether the Act permits warehouses either to redeliver goods or to issue duplicate warehouse receipts when the person who received the original documents now claims that those documents were stolen. In reality, the problem only exists as to stolen negotiable documents. Negotiable documents, particularly bearer documents, are equivalent to currency and must be safeguarded accordingly. The problem does not exist as to stolen non-negotiable warehouse receipts. See 57 Fed. Reg. 57648 (Dec. 7, 1992) (amending regulations relating to lost and destroyed warehouse receipts).

The regulations prohibit warehouses from redelivering goods until negotiable receipts are returned and canceled. 7 C.F.R. § 736.24 (1993). In light of this language, courts could possibly conclude that warehouses cannot redeliver until the stolen negotiable warehouse receipt is somehow, someday located. On the other hand, courts could also decide that putting persons who received the original documents into legal limbo because of the actions of a thief is unfair. If courts felt this unfairness, then courts could decide that stolen documents should be treated like lost or destroyed documents and apply section 261 of the Act and section 736.21 of the regulations to allow redelivery. If courts treated stolen documents like lost or destroyed documents under the Act, then courts would adopt the same resolution to the dilemma as the U.C.C. has adopted. Furthermore, the Act and the U.C.C. then would manifestly have compatible interpretations.

130. Non-negotiable receipts do not really present problems and are handled differently. 7 C.F.R. § 736.21(c) (1993). See 57 Fed. Reg. 57648 (Dec. 7, 1993) (amending regulations relating to lost or destroyed warehouse receipts).

tions 7-402 and 7-601. Warehouses issuing duplicate receipts must conspicuously note on the receipts that they are duplicates.¹³¹ Before the warehouse issues the duplicate receipts, the warehouse must receive two items from the person seeking the duplicate receipts.¹³² First, the warehouse must obtain an affidavit regarding entitlement, no negotiation or assignment, circumstances of loss or destruction, and efforts to locate lost receipts. Second, the warehouse must receive a bond in an amount double to the value of the agricultural products for which duplicate receipts are sought. If these standards are satisfied, then warehouses may issue duplicate warehouse receipts for lost or destroyed negotiable warehouse receipts. Thus, in terms of the standards for warehouses issuing duplicate receipts, the Act and the U.C.C. are compatible.¹³³

Unlike U.C.C. sections 7-402 and 7-601, the Act does not address specifically whether warehouses issuing duplicate warehouse receipts can be held liable for damages caused by their issuance. The Act does not have a safe harbor procedure like that described in U.C.C. section 7-601(1). Federally licensed warehouses might be able to use federal interpleader procedures¹³⁴ to gain an equivalent judicial safe harbor. However, section 261 and its implementing regulation, 7 C.F.R. § 736.21, contemplate warehouses issuing duplicate receipts without a court order providing protection for the warehouses' actions.

Outside the safe harbor court procedure, U.C.C. section 7-601(2) imposes potentially broad liability upon warehouses. Will courts in-

131. 7 C.F.R. § 736.21(a) (1993).

132. *Id.* § 736.21(b).

133. The language of section 261 makes reference to warehouses issuing duplicate receipts in compliance with the laws of any applicable state laws. Without knowing the history of the Act, a reader could interpret this statutory language as adopting state law (i.e., U.C.C. Article 7) as the governing law for lost or destroyed federal warehouse receipts.

Adopted in 1916, the statutory language of section 261 remains as originally written. 39 Stat. 489 (1916). In 1916, section 269 of the Act made the Act subordinate to state laws governing warehouses. 39 Stat. 490 (1916). Thus, in 1916, the language of section 261 meant that applicable state law did govern lost or destroyed federal warehouse receipts.

In 1931, Congress amended section 269 to give exclusive jurisdiction to the U.S. Secretary of Agriculture with respect to warehouses voluntarily securing a license under the Act. In *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947), the Supreme Court interpreted the 1931 amendment to mean that the Act preempted all state laws previously applied to federally licensed warehouses on any matter addressed in any way by the Act. Section 261 addresses this matter of lost or destroyed federal warehouse receipts. Therefore, after 1931, there are no longer any *applicable* state laws on lost or destroyed warehouse receipts. Consequently, after the 1931 amendments, section 261 and its implementing regulations are the exclusive law governing lost or destroyed federal warehouse receipts despite the language of section 261 referring to state laws.

134. FED. R. Civ. P. 22. U.C.C. Article 7 also has an interpleader section. U.C.C. § 7-603.

terpret the Act similarly to impose potentially broad liability upon warehouses that complied with the regulatory standards of section 736.21? Presently, the answer to this question is unclear. The question may be moot because under section 736.21 warehouses cannot issue duplicate receipts unless they receive a bond in double the amount of the agricultural products represented by the receipts. This bond is meant to indemnify anyone suffering damages because of the issuance of duplicate receipts. Thus, the bond provides financial protection to federally licensed warehouses even if the Act does impose legal liability for issuing duplicate receipts. Taking the required bond into account, the Act and U.C.C. sections 7-402 and 7-602(1) are compatible even if the precise interpretation given to the Act differs from that given to the U.C.C.

H. REDELIVERY CONDITIONS AND CANCELLATION

Section 7-403 of the U.C.C. provides two conditions for redelivery. In section 7-403(2), persons claiming the goods must satisfy the warehouse lien if the bailee requests or, if by law, the bailee cannot deliver until the charges are paid. In section 7-403(3), the person claiming the goods must surrender any outstanding negotiable documents, and the warehouse must conspicuously mark that the documents have been canceled or that partial redelivery has been made. If the warehouse fails to make these conspicuous notations, then the warehouse is liable to any person to whom the negotiable document is duly negotiated.

Section 262 of the Act sets the same two conditions for redelivery as provided by U.C.C. section 7-403. However, section 262 approaches these two conditions differently.¹³⁵ Under section 262, the persons claiming the goods must offer to satisfy the warehouse lien and offer to surrender negotiable receipts or, if the receipts are non-negotiable, offer to sign an acknowledgement of receipt for the goods redelivered. In the regulations, the Secretary of Agriculture interpreted the offer language of section 262 to mean that persons claiming the goods must first surrender negotiable receipts so that the warehouse can cancel them¹³⁶ and, only if partial redelivery has been made, issue a new negotiable receipt for the undelivered portion.¹³⁷ In *Schilling v. A.L.*

135. Section 262 also states that when the person claiming the goods surrenders the negotiable warehouse receipts that person must provide the necessary indorsement. This indorsement requirement in section 262 has a counterpart in U.C.C. § 7-506.

136. 7 C.F.R. § 736.24 (1993).

137. *Id.* § 736.23.

Book,¹³⁸ the court ruled that the regulation conflicted with section 262 of the Act and found it invalid. The court held that the person claiming the goods under a federal warehouse receipt only had to make the offer to surrender and the offer to pay before the person was entitled to receive the goods.

In light of the statutory language of section 262 of the Act and *Schilling*, the Act and U.C.C. section 7-403 differ regarding the precise choreography of redelivery. Although feelings of mistrust can arise between a bailor and a bailee, courts should not find that legal rights and responsibilities of bailors or bailees depend upon who takes the first step in redelivery transactions. Thus, the different choreography of delivery conditions between the Act and U.C.C. section 7-403 does not render them incompatible.

Section 263 of the Act mandates that warehouses plainly cancel each warehouse receipt upon its face at the time of redelivery. In the implementing regulations,¹³⁹ the Secretary correctly distinguishes negotiable warehouse receipts from non-negotiable warehouse receipts. Only negotiable warehouse receipts need conspicuous notations of cancellation.¹⁴⁰ Therefore, section 263 and its implementing regulations are compatible with U.C.C. section 7-403(3).

Unlike the U.C.C. section 7-403(3), section 263 and its implementing regulations do not address the risk of liability to warehouses if they fail to mark a negotiable warehouse receipt canceled, or fail to cancel an original negotiable receipt and replace it with a new negotiable warehouse receipt in partial redelivery situations, and the original receipts thereby remain in the stream of commerce. Courts might interpret the Act like the U.C.C. and impose liability upon warehouses that have failed to perform their statutory duties to cancel. Courts should place liability on warehouses that can prevent the harm rather than on persons to whom the original documents are duly negotiated.

In sum, sections 262 and 263 of the Act and U.C.C. section 7-403 are compatible. No significant conflict exists between the Act and U.C.C. Article 7 concerning redelivery conditions and cancellation.

I. MINGLING OF AGRICULTURAL PRODUCTS

Section 7-207(1) of the U.C.C. provides that warehouses have the basic duty to keep separate the goods being stored by various deposi-

138. 405 N.E.2d 824 (Ill. App. Ct. 1980). The Secretary of Agriculture has not amended 7 C.F.R. § 736.24, ruled invalid in the *Schilling* case, to conform the regulation to the *Schilling* holding.

139. 7 C.F.R. §§ 736.23, 736.24 (1993).

140. See 57 Fed. Reg. 57647 (Dec. 7, 1992) (amending regulation governing return of receipts before delivery).

tors, except that fungible goods may be mingled. Section 258 of the Act uses different language but creates identical duties for federally licensed warehouses of agricultural products. Because the Act deals with agricultural products, section 258 emphasizes that agricultural products are not considered fungible for mingled storage unless all products stored together are of the same kind and grade.

IV. CONCLUSION

Although there may be additional areas of potential conflict between the United States Warehouse Act ("Act") and Uniform Commercial Code Article 7 ("Article 7"), the nine substantive comparisons discussed are most important. Areas of tension between the Act and Article 7 may exist that could lead to incompatible interpretations and results in similar legal dilemmas. Overall, the Act and Article 7 are fully compatible. Even in areas of tension, courts can interpret the Act and Article 7 in compatible ways. Therefore, if significant incompatibility arises between the Act and Article 7, it will be because courts have chosen an incompatible interpretation, not because the statutory language or structure exacts incompatibility.