Good Faith Purchase and Warehouse Receipts: Thoughts on the Interplay of Articles 2, 7, and 9 of the UCC

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Recommended Citation
Available at: https://repository.uchastings.edu/hastings_law_journal/vol30/iss1/1
In Articles 2, 7, and 9, the Uniform Commercial Code1 weaves a complex pattern for resolving the commercial confrontation between secured parties and commodity paper purchasers. The pattern rests on the commercial doctrine of good-faith purchase2 and the related theories of estoppel, negotiability, and buyer in ordinary course. In addition, the distinction between buyers and lenders, that is, the distinction between the marketing and the financing functions of documents of title, supports the framework of these rules. Generally, courts have failed to perceive the structure established by the Code. They often apply Article 9 to situations governed by Article 7, and demonstrate a lack of awareness of the critical role of Article 2 and the doctrine of good-faith purchase.

In an attempt to alleviate confusion and to demonstrate the integrity of the present structure, this Article posits the following propositions. First, “qualified holders,” those to whom negotiable documents of title have been duly negotiated, derive their rights as against true owners and secured parties from Article 7, although Article 7 sometimes defers to Article 9 in this regard. Second, Article 7 posits a general rule that “nonqualified holders” of documents of title, whether negotiable or nonnegotiable, take no better interest than their transferors held or had actual authority to convey. This general rule, however, is subject to the operation of various buyer protection provisions of Articles 2, 7, and 9, and therefore courts must determine whether the

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1. Hereinafter referred to as “Code.” All sections and comment references, unless otherwise noted, are to the 1972 Official Version of the Uniform Commercial Code.
nonqualified holder is a buyer or lender. Third, nonqualified holders who are lenders derive their rights from Article 9. Finally, this Article contends that courts frustrate the Code's attempt to strike a proper balance among the competing interests by failing to accord due deference to the doctrine of estoppel in documentary transactions. Because these questions arise most frequently in the context of warehouse receipts, the inquiry must begin with a consideration of warehouse-receipt transactions.

**Functions of the Warehouse Receipt**

Historically, documents of title such as warehouse receipts facilitated the practice of storing and transporting commodities. More recently, the receipt has taken on significant marketing and financing features.

**The Marketing Function**

For some purchasers, delivery is not an essential part of the purchase transaction. Grain dealers, for example, frequently purchase from producers and sell to industry consumers without moving the grain from the elevators to which the producers delivered it for drying and storing after harvest. Customarily these buyers and sellers effect such transfers by negotiable warehouse receipts. The producer obtains the receipt, which describes the grain according to industry standards; the grain dealer then purchases the receipt and transfers it, perhaps through a series of buyers, to a buyer who desires to ship or otherwise take possession of the grain. This last purchaser then surrenders the receipt to the elevator and takes delivery. The result is that the parties have achieved the marketing of the grain without incurring unnecessary transportation expenses.

Similarly, in the cotton industry a producer will deliver cotton to a gin for processing and storing. The gin will issue a negotiable receipt for the cotton with a sample attached. Brokers then display the samples to buyers who may be located in markets distant from the gin. Upon receipt of a satisfactory offer, the broker forwards the receipt with a draft through banking channels. When the purchaser honors the draft the bank delivers the receipt; the purchaser, unless he desires

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to resell the cotton without taking possession, will surrender the receipt to the gin and take delivery of the goods. Again, the receipt simplifies the marketing process and saves transportation costs.

The Financing Function

In transactions similar to the foregoing illustrations, market conditions or production schedules may force a buyer to hold a commodity. During that interval the buyer owns a valuable asset but cannot utilize it and, therefore, may seek to borrow against it. Lenders will grant credit on the security of the stored commodity by taking the negotiable warehouse receipt. When the borrower finds a buyer for the commodity or is prepared to use it in its own production process, the borrower will pay off the loan, obtain the receipt from the creditor and surrender the receipt to the warehouse against delivery of the goods.

Some borrowers use nonnegotiable receipts in connection with inventory financing. This form of inventory loan satisfies a lender’s policing requirements in situations in which the lender fears his collateral may disappear quickly. The borrower delivers the inventory to a “field warehouse,” usually a part of the borrower’s premises controlled by an independent, field-warehouse company. The warehouse then issues nonnegotiable receipts to the lender. When the borrower needs inventory to fill customer orders, he will satisfy a portion of the loan; the lender in turn will issue delivery orders to the field warehouse, which will then release part of the inventory to the borrower.

These models illustrate typical patterns through which business people employ warehouse receipts to save transaction costs and to achieve liquidity. The models also forecast the potential conflicts in these commodity paper transactions. With respect to each purchase, for example, there is the classic tension between the purchaser, on the one hand, and the seller’s secured lender, on the other. Conflicts between purchasers and lenders claiming an interest in the same goods may also arise because some sellers will enter into a contract of sale with more than one buyer or grant a security interest to more than one lender.

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The Qualified Holder

The Negotiable Receipt and the Qualified Holder

Because the negotiable receipt facilitates the marketing of commodities and the use of inventory as collateral for loans, the Code should protect both of these functions. It does. The principal beneficiary of this protection is the qualified holder. Qualification of a holder for this purpose requires compliance with transfer rules similar to those for negotiable instruments. The holder must purchase for value, in good faith, and without notice of any defense or claim;6 bearer documents need only be delivered, and order documents must be endorsed as well as delivered.7

Article 7 imposes the additional requirement that the holder qualifies only when the negotiation is in “the regular course of business or financing.”8 This feature of warehouse receipt negotiation knows no counterpart in negotiable instruments law. The comment to section 7-501 makes it clear that this requirement is dictated by the mercantile foundation of the doctrine of good-faith purchase.9 The Code affords the benefit of good-faith purchase in commodity paper transactions only if the setting is strictly commercial. Only a person “in the trade”10 can negotiate such a document and then only in connection with a transfer commercial in nature.11 Most good-faith-purchase sections of the Code invoke a similar requirement by virtue of their application only to sales out of inventory.12

This additional regular-course-of-business or financing requirement serves to raise the level of good faith imposed on a qualified holder. Although the good-faith requirement of Article 7 is subjective,13 the comments imply persuasively that the commercial feature of documentary negotiation operates to protect against conduct by a

7. U.C.C. § 7-501(1); cf. U.C.C. § 3-202(1) (negotiable instruments rule).
9. U.C.C. § 7-501, comment 1. “The reason for allowing a person, in bad faith or in error, to convey away rights which are not his own has from the beginning been to make possible the speedy handling of that great run of commercial transactions which are patently usual and normal.” Id. See also Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057, 1060 (1954); Warren, supra note 2, at 484-85.
11. “Obviously, the snapping up of goods for quick resale at a price suspiciously below the market deserves no protection . . . : it is . . . outside the range of regular course.” Id.
13. See U.C.C. § 1-201(19).
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holder which suggests objective bad faith.14

A significant benefit accruing to the qualified holder of a negotiable receipt involves the dual marketing and financing features of commodity-paper negotiation. It is a conclusion of this Article that certain good-faith-purchase benefits accrue to nonqualified holders only if they take as buyers, as opposed to creditors.15 By specifically referring to "regular course of business or financing" in section 7-501(4), the Code makes it clear that this distinction does not operate in the qualified-holder situation.16 The qualified holder benefits from good-faith-purchase rules regardless of whether that holder is a buyer or lender. Furthermore, section 7-502 provides that a qualified holder of a negotiable document acquires title to the goods in addition to title to the document,17 in contrast to the position of a lender holding a nonnegotiable receipt, who does not obtain title to the underlying commodity.18

In addition, the qualified holder defeats claims to the document itself and defeats most others who assert an interest in the goods.19 The qualified holder also benefits from agency and estoppel rules. For example, qualified holder status will defeat the argument that the bailor delivered the goods after the bailee issued the receipts.20 In this way, section 7-502 codifies the rule of Baldwin v. Childs,21 a leading pre-Code bill of lading case. This rule is akin to the estoppel by deed rule of real property law.22 Such estoppel benefits neither accompany nonnegotiable receipts nor negotiable receipts which are not duly

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14. See U.C.C. § 7-501, comment 1, para. 3.
15. See text accompanying notes 112-18 infra. This buyer-creditor distinction is found elsewhere in the Code. Compare U.C.C. § 1-201(9) with U.C.C. § 1-201(32)-(33).
16. Cf. U.C.C. § 9-102(1)(b) (Article 9 treats in the same fashion those who buy chattel paper and those who lend against chattel paper). Thus the Code does not distinguish between buyers and lenders who hold chattel paper or who hold negotiable commodity paper which has been duly negotiated to them.
18. See note 194 infra.
19. "Subject to the following section, title and rights so acquired are not defeated by any stoppage of the goods represented by the document or by surrender of such goods by the bailee, and are not impaired even though the negotiation or any prior negotiation constituted a breach of duty or even though any person has been deprived of possession of the document by misrepresentation, fraud, accident, mistake, duress, loss, theft, or conversion, or even though a previous sale or other transfer of the goods or document has been made to a third person." U.C.C. § 7-502(2).
20. U.C.C. § 7-502(1)(c) and comment 2.
negotiated.  

In sum, the qualified holder occupies a highly advantageous position.  

Provided the issuing warehouse retains possession of the goods, the qualified holder need not fear encroachment from buyers, other secured parties, or attaching creditors.  

Furthermore, Article 7 extends these benefits through a shelter provision, which brings subsequent transferees under the umbrella of the qualified-holder transferor.  

Thus, a transferee who takes from a qualified holder but who does not take by due negotiation nonetheless enjoys the benefits of qualified holder status to the extent his transferor enjoyed them.  

Within the scope of the present inquiry, the only real concern for the qualified holder is the possibility that conflicting rights may have accrued prior to the time the original holder of the receipt bailed the goods.

The Qualified Holder and Paramount Rights: Section 7-503

The most important feature of the Article 7 system for balancing security of property interests against open market interests is section 7-503. In this section the doctrine of good-faith purchase confronts the tension between the conflicting policies of security of title and free movement of goods, and section 7-503 initially resolves this conflict in favor of security of property. The qualified holder and his transferee take subject to that class of persons identified in section 7-503(1) as enjoying rights paramount to those of the qualified holder. "A document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in them . . . ."
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The intended application of the rule is most easily illustrated by the classic “thief” situation. The doctrine that the thief cannot convey good title is a sanction particularly strong with respect to the sale of goods. Section 7-503 supports this principle by refusing to permit a thief who cannot give good title to the goods themselves to improve the position of his buyer by bailing the goods and selling the buyer a document of title. After positing this paramount rights rule, section 7-503(1) then establishes an exception to it. Although technically leaving room for the application of the general principle, the exception has so occupied lawyers and judges as to dominate the principle. The exception rests on traditional notions of actual authority, apparent authority, and estoppel. A person with paramount rights falls within the exception when such person: delivers or entrusts the goods (or document of title covering them) to a party who becomes the bailor with actual or apparent authority to bail or power to obtain delivery of the goods; delivers or entrusts the goods (or document of title covering them) with power to convey good title under either of the open market provisions in Article 2 (section 2-403) or Article 9 (section 9-307); or acquiesces in the procurement of the document by the person who becomes the bailor. The first two situations cover instances of active delivery and entrustment; the provision covering acquiescence serves to catch those who passively allow another to obtain apparent authority to convey. This exception is nothing more than application of a well-settled legal notion: the principle that when the conduct of a person contributes to confusion, that person is precluded from asserting paramount rights only persons who can obtain goods subject to a negotiable receipt without delivering that receipt).

30. The rule that a thief can give no title applies except in certain instances when the thief transfers money or transfers an instrument, document or security in bearer form. A good faith purchaser who takes from the thief who stole such property may defeat the true owner. See generally R. Brown, The Law of Personal Property § 9.5 (3d ed. 1977).

31. The thief rule is the first corollary of the principle that one who has no title cannot convey title. Nemo dat quinon habet. See Lindsay v. Cundy, 3 App. Cas. 459, 463-64, 47 L.J.Q.B. 481, 483 (H.L. 1878).

32. “A thief of the goods cannot indeed by shipping or storing them to his own order acquire power to transfer them to a good faith purchaser.” U.C.C. § 7-503, comment 1; accord, 2 S. Williston, The Law Governing Sale of Goods § 421 (rev. ed. 1948); cf. U.C.C. § 7-209, comment 3 (if the thief bails stolen goods, the true owner is not subject to the warehouse lien).

33. U.C.C. § 7-503(1)(a).

34. Id.

35. U.C.C. § 7-503(1)(b).

36. “[F]or seeing somebody must be a loser by this deceit, it is more reason that he that employs and puts a trust and confidence in the deceiver should be a loser, than a stranger . . . .” Henn v. Nichols, 91 Eng. Rep. 256 (K.B. 1701).
against the person misled.\textsuperscript{37}

There is a further point that merits attention. Section 7-504(1) specifies that a nonqualified holder can never take better title via the warehouse receipt than his transferor "had or had actual authority to convey."\textsuperscript{38} Clearly, then, as the cross reference in the qualified-holder provision suggests,\textsuperscript{39} section 7-503 applies only to holders to whom a document of title has been duly negotiated, that is, qualified holders.\textsuperscript{40} This conclusion is confirmed by the comment to section 7-504(1), which asserts that any party who is not a qualified holder of a negotiable document derives no benefit from estoppel.\textsuperscript{41} It follows, then, that only the qualified holder can benefit from the exception of section 7-503, which is basically an estoppel rule. The estoppel does not apply to nonnegotiable documents or to nonqualified holders of negotiable documents. Holders of nonnegotiable documents and nonqualified holders of negotiable documents lose to the owner or prior secured party asserting a paramount title under the terms of section 7-504, not section 7-503.\textsuperscript{42}

The conclusion that the exception to section 7-503 operates to deprive the person with paramount rights of those rights in favor of the qualified holder, finds only mixed support in the cases. Two decisions which involve nonnegotiable warehouse receipts, and in which, therefore, section 7-503 should have no application, state unequivocally that the estoppel exception of section 7-503 does not deprive the true owner or prior secured party of paramount rights.\textsuperscript{43} On the other hand, the

\textsuperscript{37} This reading of the rule is analogous to the provision of § 7-207(2) which by operation of law, rather than estoppel, gives qualified holders rights in fungible and commingled goods when the warehouse overissues receipts. Section 7-207(2), then, deprives the true owner of part or all of his interest as does § 7-503(1). \textit{See} \textit{3 New York Law Revision Commission, Study of the Uniform Commercial Code} 1796-97 (1955).

\textsuperscript{38} Note, moreover, that the comment explicitly negates any argument that a negotiable document can augment the title of such a transferee. \textit{U.C.C.} § 7-504, comment 1.

\textsuperscript{39} Section 7-502 expressly renders the rights of a qualified holder subject to the rule of § 7-503.

\textsuperscript{40} \textit{See} \textit{U.C.C.} § 7-503, comment 1.

\textsuperscript{41} \textit{U.C.C.} § 7-504, comment 1.

\textsuperscript{42} That is, holders of nonnegotiable documents and nonqualified holders of negotiable documents lose in all instances when they assert rights as holders of the instrument only. To the extent that they qualify for protection under other rules of the Code they may prevail over the true owner or prior secured party. \textit{See} \textit{U.C.C.} §§ 2-403(2), 9-307(1).

\textsuperscript{43} "But neither does the Code divest an entruster such as Boody of all its rights, and no implication that it does arises from Section 7-503(1)." \textit{Philadelphia Nat'l Bank v. Irving R. Boody Co.}, 1 \textit{U.C.C. Rep. Serv.} 560, 567 (arb. dec. 1963) (Funk, arb.). "The Bank incorrectly infers that the reverse is therefore true, and that § 7-503(1) operates to divest a prior secured party of his security interest if he has done or acquiesced in such acts. But that is not what the section says. Had the drafters of the Code meant to grant priority to
leading commentators are united in their support of the general proposition that those who fall into the estoppel exception thereby lose their paramount rights.\textsuperscript{44} The dicta of those two decisions, then, should not overcome the contrary implications of other authority and the plain import of the statute.\textsuperscript{45}

The scope of the exception rests not so much on fact situations as it does on the purpose of the section itself, that is, to preclude the person with paramount rights from asserting those rights against a qualified holder when such an assertion smacks of unfairness. Other estoppel provisions of the Code, and pre-Code law, provide some direction in defining the boundaries of the exception.

\textit{Inventory}

The estoppel rule most clearly applies in those situations where the goods covered by the negotiable documents are part of the bailor's inventory.\textsuperscript{46} By definition, documents of title represent goods.\textsuperscript{47} The estoppel rules for the sale of goods in Article 2\textsuperscript{48} and Article 9\textsuperscript{49} apply to sales out of inventory. Only the buyer in ordinary course benefits from those estoppel rules. A buyer in ordinary course is a buyer from one "in the business of selling goods of that kind,"\textsuperscript{50} that is, a buyer of the holder of the document in such a situation, they could have done so in simpler language than that which was used. They could have spoken affirmatively instead of negatively, and could have provided simply that: a document of title takes priority over the rights of a person who before issuance had a legal interest or a perfected security interest if such person either (a) delivered or entrusted the goods, etc., or (b) acquiesced, etc." Douglas-Guardian Warehouse Corp. v. Esslair Endsley Co., 10 U.C.C. Rep. Serv. 176, 188-89 (W.D. Mich. 1971). In Philadelphia Nat'l Bank v. Irving R. Boody Co., 1 U.C.C. Rep. Serv. 560 (Arb. Dec. 1963) (Punk, Arb.), the arbitrator concluded that § 7-503(1) implies only that the holder gets "some" rights and that the Code defines these rights elsewhere than in § 7-503. This position is theoretically correct in that the Code does define these rights in the preceding section, § 7-502, which is, however, subject to § 7-503; and if § 7-503 does not apply because of the entrusting or acquiescing exceptions, § 7-502 does. Under § 7-502, the qualified holder gets title to the document and title to the goods free from all claims.

\textsuperscript{44} R. Braucher, \textit{Documents of Title} 62-65 (1958); I. G. Gilmore, \textit{Security Interests in Personal Property} § 6.6, at 173 n.6 (1965); J. White & R. Summers, \textit{Handbook of the Law Under the Uniform Commercial Code} 700-01 (1972); Warren, \textit{supra} note 2, at 486.

\textsuperscript{45} See United States v. Hext, 444 F.2d 804, 814 n.34 (5th Cir. 1971).

\textsuperscript{46} The inventory, that is, not in the narrow Article 9 definition of the term, see U.C.C. § 9-109(4), but in the broader and commonly accepted use of the term. Thus bailed farm products, though arguably not inventory, see U.C.C. § 9-109(3), should be considered inventory for the purposes of this discussion.

\textsuperscript{47} U.C.C. §§ 1-201(15).

\textsuperscript{48} U.C.C. § 2-403(2).

\textsuperscript{49} U.C.C. § 9-307(1).

\textsuperscript{50} U.C.C. § 1-201(9).
Reference in section 7-503 to Article 9 should, in Professor Gilmore's judgment, leave no doubt that the estoppel rule of section 7-503 applies to inventory. "The cross reference to § 9-307 means . . . that there is nothing a secured party can do to protect himself against the contingency of a fraudulently procured document with respect to collateral which is inventory held by a debtor for sale . . . ."\(^{52}\)

The requirement that due negotiation of a document of title includes establishing that the transfer is in the regular course of business supports the same conclusion. A transfer of a document of title covering goods by one who regularly deals in goods of the kind goes far to show the transfer to be in the regular course of business. Clearly, then, entrustment and delivery of inventory are prime situations for application of the estoppel rule; but, unlike the estoppel rules of Articles 2 and 9, there are more situations under Article 7 that benefit from the estoppel principle.

**Finance**

Documents of title figure in more than the marketing of goods. Due negotiation of such documents includes not just transfers in the regular course of business but transfers in the regular course of finance as well. The inventory limit of the Article 2 and Article 9 good-faith-purchase provisions cannot serve as a restriction on the estoppel rule of Article 7, as it does on the analogous rules of those other articles. Documents of title serve important financing functions. In the regular course of finance they come into the hands of brokers, banks, and other investors who do not necessarily deal in the commodities the documents represent. In this sense documents of title are more like negotiable instruments and securities whose estoppel rules do not feature an inventory element.\(^{53}\) Because documents of title serve both market and finance functions, entrusting goods or documents to one who deals in such commodities will provide an appropriate setting for invoking the estoppel rule of section 7-503. Similarly, entrusting goods or documents to one who regularly engages in financing transactions involving such documents may also give rise to an estoppel argument.

**Knowledge**

In either event, the question arises whether the estoppel applies if the entruster does not know or does not have reason to know the busi-

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51. See U.C.C. § 9-109, comment 3.
53. See U.C.C. §§ 3-405, 3-406, 4-406, 8-205, 8-206, 8-311.
ness of the entrustee. Code provisions are silent on this point. Two cases suggest that such knowledge is a prerequisite to estoppel. Other authority posits a knowledge requirement in the analogous rules of section 2-403(2) and section 7-205.

Professor Warren criticizes the addition of this requirement. He asserts that the introduction of the knowledge requirement invites inquiry into the entruster’s state of mind. Courts traditionally have refused to pursue that inquiry in questions involving negotiable instruments. These cases reason that the trouble of ascertaining the state of mind of a drawer or maker seriously hampers the certainty element which is critical to the success of negotiable instruments. It is enough, this reasoning holds, that the form of the instrument is negotiable; the drawer’s unawareness of that fact is immaterial.

Professor Warren’s view is more persuasive in the realm of negotiable instruments than in the realm of fungible goods. The dangers of uncertainty are considerably less severe in the former situation; it is far more difficult for an entruster to claim a lack of knowledge of the business of the entrustee than it is for the drawer to claim a lack of appreciation of the significance of negotiable language. The entruster alleging a lack of knowledge, moreover, must shoulder the burden of proof.

Finally, the knowledge requirement reflects the equitable origins of these estoppel rules and recognizes the unfairness of charging a delivery with free market implications when the entruster has no reason to know that he is delivering to one in a position to deal with good faith purchasers. While it may be argued that a careful entruster will always be more able than the good faith purchaser to avoid this type of situation, the fact remains that an entruster may not know all facets of an entrustee’s business affairs. Moreover, a rule which deprives the innocent, unknowing entruster of title may strike courts as unduly

54. United States v. Hext, 444 F.2d 804, 814-15 n.34 (5th Cir. 1971); Porter v. Wertz, 23 U.C.C. Rep. Serv. 614 (N.Y. Sup. Ct. 1978); cf. Lundy v. Greenville Bank & Trust Co., 179 Miss. 282, 174 So. 802 (1937) (pre-Code) (true owner estopped when he should have known that broker was dealing with his receipts); Fourth Nat’l Bank v. St. Louis Cotton Compress Co., 11 Mo. App. 333 (1882) (pre-Code) (true owner should have known factor was borrowing on receipts).


56. R. Braucher, Documents of Title 66 (1958).

57. Warren, supra note 2, at 473-74.


harsh and may invite troublesome exceptions. On balance, then, commercial lawyers might do well to accept the knowledge requirement.

Pre-Code Authority

In addition to these general guidelines, pre-Code commercial cases and statutes illustrate the way in which the estoppel rule of section 7-503 should operate. In the nineteenth century, factors who undertook to sell a producer's goods played a chief role in the marketing of commodities. At an early date, the common law recognized the utility of protecting good faith purchasers who did business with such factors. Accordingly, the common law clothed such buyers with good title even though the factor exceeded his authority. The courts adhered, however, to a rigid distinction which denied similar protection to pledgees; it was the general rule at common law that a factor could not pledge absent his principal's authority. Legislatures overcame this distinction with the early factors acts, which obliterated that distinction and gave factors authority to pledge. Other provisions in the factors acts, the Uniform Sales Act, and the Uniform Warehouse Receipts Act made it clear that by entrusting a negotiable document to a factor, the true owner empowered the factor to sell or pledge the goods or the document.

The adoption of the Code and the repeal of the uniform acts should not be viewed as a retreat from these efforts to promote the cause of commercial celerity. The language of section 7-503(1)(a)

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60. A factor was one who dealt for his principal and also held the goods. He was different from a broker who did not hold the goods. F. TIFFANY, HANDBOOK OF THE LAW OF PRINCIPAL AND AGENT § 24, at 64 (2d ed. 1924).
61. See L. VOLD, HANDBOOK OF THE LAW OF SALES § 73, at 368-70 (2d ed. 1959); cf. U.C.C. § 9-306(2) (a secured party who authorizes the sale of goods by the debtor thereby loses his security interest in the collateral upon that sale).
63. These early acts, unlike more recent factors' lien acts patterned on the New York statute, deal with factors who operate in a merchandising capacity, not as lenders. See N.Y. PERS. PROP. LAW § 45 (repealed 1964).
64. See, e.g., Factors Act, 1889, 52 & 53 Vict., c. 45, § 2(1).
65. See, e.g., N.Y. PERS. PROP. LAW § 43(1) (repealed 1964).
66. UNIFORM SALES ACT § 32(b) (superseded by U.C.C. 1951).
67. UNIFORM WAREHOUSE RECEIPTS ACT § 40; cf. UNIFORM BILLS OF LADING ACT § 31 (which achieves the same result for bills of lading).
which brings one who entrusts "with actual or apparent authority to ship, store or sell" within the estoppel rule and the reference in the comment to factors and to the early factors acts demonstrate that the drafters were mindful of these efforts and were conforming section 7-503 to them.\textsuperscript{69} Section 7-503 continues the established principle that one who entrusts a document of title to a merchant who deals in the goods\textsuperscript{70} or entrusts the goods themselves to such a merchant\textsuperscript{71} will be estopped to allege paramount rights.

These, however, are easy cases. Similarly, it is easy to state the rule that a thief cannot bind the true owner\textsuperscript{72} and that a document procured by a thief can carry no title to the qualified holder.\textsuperscript{73} There underlies these clear rules a broad range of factual settings which provide fertile ground for the imaginative litigant. One who deals, for example, with the dishonest employee of a true owner can find pre-Code precedent\textsuperscript{74} and analogous rules in the article on commercial paper\textsuperscript{75} to support a claim that the case does not fall within the thief rule but is instead a candidate for the operation of estoppel.

Similarly equivocal is the farm landlord situation. The tenant delivers crops to a warehouse in return for negotiable warehouse receipts and then negotiates them. At first blush it seems harsh to estop the landlord from asserting his crop lien,\textsuperscript{76} and courts have traditionally

\textsuperscript{69} "On the other hand, where goods are delivered to a factor for sale, even though the factor has made no advances and is limited in his duty to sell for cash, the goods are 'entrusted' to him 'with actual . . . authority . . . to sell' under subsection (1)(a), and if he procures a negotiable document of title he can transfer the owner's interest to a purchaser by due negotiation. Further, where the factor is in the business of selling, goods entrusted to him simply for safekeeping or storage may be entrusted under circumstances which give him 'apparent authority to ship, store or sell' under subsection (1)(a), or power of disposition under Section 2-403, 7-205 or 9-307, or under a statute such as the earlier Factors Acts, or under a rule of law giving effect to apparent ownership. See Section 1-103." U.C.C. § 7-503, comment 1.


\textsuperscript{71} See, e.g., Arbuthnot v. Central Trust Co. (In re Richheimer), 221 F. 16 (7th Cir.), cert. denied, 238 U.S. 624 (1915).

\textsuperscript{72} See notes 30-31 and accompanying text supra; cf. Wheelwright v. Depeyster, 1 Johns. 471, 3 Am. Dec. 345 (N.Y. 1806) (where the buyer traced title from a pirate).

\textsuperscript{73} Lineburger Bros. v. Hodge, 212 Miss. 204, 54 So. 2d 268 (1951).

\textsuperscript{74} See, e.g., Flexner v. Meyer's Ex'x, 191 Ky. 133, 229 S.W. 99 (1921).

\textsuperscript{75} The fictitious payee rule of § 3-405(1)(c) precludes an employer from asserting that the signature of an indorser is forged when the employer puts the employee in a position to commit or facilitate the forgery. Cf. § 4-406 which requires a checking account customer to use reasonable care and promptness in examining account statements or be precluded from asserting that a signature on a check was forged.

\textsuperscript{76} The landlord's lien is a creature of statute, which usually does not require the filing
displayed a stubborn reluctance to preclude the landlord from asserting that lien against purchasers. The reluctance parallels the even stronger common-law tradition of protecting farm creditors from buyers in the open market.

The Code continues that protection for farm creditors but not for landlords. The tenant cannot defeat the landlord's interest "merely by wrongfully shipping or storing . . . the crop[s]," but, "knowledge of the likelihood of storage or shipment with no objection or effort to control it is sufficient to defeat" the landlord's rights. Custom, usage of trade, and reasonable expectations, therefore, will play a role in determining whether the qualified holder defeats the landlord's lien.

*Cleveland v. McNabb* confronted one court with an opportunity to weigh the propriety of invoking estoppel in a farm-landlord situation. The Commodity Credit Corporation loaned money to a farmer and took negotiable warehouse receipts covering the farmer's crops grown on real estate owned by the plaintiffs. Tennessee's crop lien statute gave the plaintiffs a lien superior to those of a buyer. The Commodity Credit Corporation and the codefendant argued that by not exercising control over the farmer, the plaintiffs "acquiesced" in the procurement of the document. The evidence indicated that the landlords lived a considerable distance from the farm and left the cultivating and marketing of the crops to their tenant, apparently relying either on his honesty to remit their rent or upon their lien under the crop lien statute. The Commodity Credit Corporation evidently contended that section 7-503 would operate to preclude these plaintiffs from asserting their lien. A second defendant, who purchased crops directly and not by warehouse receipt, argued common law estoppel.

Rejecting the common law estoppel argument, the court opted

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77. *Cf.* Layng v. Stout, 155 Wis. 553, 145 N.W. 227 (1914) (landlords successfully asserted claim to ownership of crop).


79. *See* U.C.C. § 9-307(1), which contains an exception for the sale of farm products.

80. U.C.C. § 7-503, comment 1.


82. The farm was situated in Fayette County, Tennessee. Plaintiffs, a doctor and his wife, lived in Cleveland, Ohio.

83. "In examining the statute, we find nowhere therein an indication that a landlord must exercise control or supervision over crops grown on his land, or that he must at any point take possession of them, and the defendants have not cited any statutory or other reference for such a proposition." *Cleveland v. McNabb*, 312 F. Supp. 155, 158-59 (W.D. Tenn. 1970).
for the statutory lien and against the open market emphasis expressed by the Code. The court avoided the thrust of section 7-503 by finding the Commodity Credit Corporation to be a nonqualified holder. The evidence showed that the records of the corporation reflected the lease. The warehouse receipts, moreover, referred to gin tickets which described the real estate on which the crop grew. Even though the farmer told the corporation's clerk who took the receipts that there was no lien, the court concluded that the corporation was charged with the knowledge which comparison of the lease and the gin tickets would have yielded. Yet the opinion nowhere indicates that the corporation had possession of those tickets. The court held further that such knowledge was sufficient to prevent the corporation from becoming a qualified holder and therefore prevented it from relying on the estoppel rule of section 7-503 to defeat the landlords.84

It is difficult to accept the court's reasoning. Assuming that the corporation should be charged with knowledge that it could have gleaned from the receipt, lease, and gin tickets (which is assuming a great deal), the court goes on to assume that such facts would include knowledge that the tenant did not pay rent to the plaintiff. In the absence of any specific evidence that the defendants had information that the tenant was not paying rent, the court seems to place the burden of investigating the business affairs of the farmer on the party claiming qualified-holder status. Such a requirement would be clearly contrary to the entire concept of due negotiation: "the speedy handling of that great run of commercial transactions which are patently usual and normal."85

It is clear from the flavor of the court's opinion that it reached its result because of the strong language in the crop lien statute favoring landlords over buyers. It is regrettable that the court did not balance that policy against the contrary and equally strong expression of policy in the Code, a more recent statute.86 Certainly the court should have questioned the policy of favoring these plaintiffs who permitted the

84. But see R.E. Huntley Cotton Co. v. Fields, 551 S.W.2d 472 (Tex. Civ. App. 1977). "Although the plaintiffs presented some evidence that the defendants had access to information sufficient to put them on notice of claims to the cotton, that knowledge is immaterial unless defendants had actual knowledge of facts and circumstances that would amount to bad faith." Id. at 476.

85. U.C.C. § 7-501, comment 1.

goods to enter the stream of commerce and then expected the loss to fall upon the buyer. It is equally obvious that the court was far more willing to require diligence on the part of the corporation but to countenance the lack of it on the part of the landlords, who were in the best position to avoid the conflict. It does not seem unreasonable, furthermore, to draw the conclusion that the court was in fact aware of the policy direction expressed in section 7-503(1)(a) and its accompanying comments. Awareness of this policy would explain the court's rather tortuous effort to find that the defendants were not qualified holders. Had the court found otherwise, section 7-503(1)(a) would have provided a compelling argument against the crop-lien statute.

In *United States v. Hext*\(^{87}\) another court preferred the open-market approach. The Farmer's Home Administration, a perfected secured party, sued various defendants involved in the marketing of cotton originally owned by the government's borrower. The borrower delivered the cotton to its own gin company, which ginned the cotton and delivered it to a warehouse for compressing. The warehouse compressed the cotton and stored it, issuing a negotiable warehouse receipt for each bail to the gin company in its own name or in the name of the borrower. The gin company sent samples of the cotton to a broker who offered the cotton for sale by sample.

The dangers of imposing strict security of property principles to this arrangement are readily apparent: if the security interest of the government prevails, each of the parties dealing with the receipts is liable in conversion.\(^{88}\) Finding the defendants liable would be inimical to the fundamental open market concepts of the Code, since it would tend to inhibit marketing of products that serve as collateral in a secured transaction.

The court turned instead to common law estoppel theories, holding that because the government knew that the farmer operated the gin, it was precluded from asserting its lien.\(^{89}\) The court noted further that application of Article 7 would yield a similar result. Because the government had "entrusted" this grower with the cotton with apparent authority to store it, the court concluded that Article 7 precluded the government from asserting its lien. The court also held that the government's conduct amounted to acquiescence in the issuance of the

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87. 444 F.2d 804 (5th Cir. 1971).
88. In *Hext*, the Government sued the grower, the gin, the warehouse, and the broker. The conversion liability rests on the common law tort of innocent intermeddling. See U.C.C. § 7-704, comment.
89. 444 F.2d at 814.
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warehouse receipt. In either event, the preclusion rule of section 7-503(1) operates and the secured party loses its priority.90

In sum, the general rule of section 7-503 that a true owner or secured party whose interest arises before the issuance of a negotiable document enjoys rights paramount to those of the qualified holder is subject to the far-reaching estoppel exception contained in the same section. While pre-Code history provides some direction, the scope of the section is vague and therefore provides fertile ground for characterization and advocacy. The purpose of section 7-503 is to balance the interests of the two relatively innocent parties, the party with prior rights and the qualified holder, by having the burden fall on the one who had the best opportunity to avoid the problem. In construing the scope of the estoppel rules, courts should bear in mind the cardinal rule of Code construction: the purpose of the section controls.91 The purpose of section 7-503, also, is to facilitate commerce by showing a preference for the qualified holder over the owner or prior secured party where the latter has allowed another to act to introduce goods into the stream of commerce. Consequently, the courts should restrict their inquiry to whether the one party is a qualified holder and whether the other party has so acted.

The Interplay of Articles 7 and 9 with Respect to Qualified Holders

Some confusion emanates from the Hext case and elsewhere over the proper role of Article 9 buyer-protection rules with respect to negotiable receipts and qualified holders. In ruling against the secured party in Hext, the court cited section 9-309 and the leading nonnegotiable receipts arbitration case, Philadelphia National Bank v. Irving R. Boody Co.92 The court thereby implies that the provision of section 9-309 might govern the paramount rights situation;93 that is, that Article 9, rather than Article 7, should resolve conflicts between prior secured parties and the qualified holder. The Boody opinion, using language in the nature of dictum, expressly comes to this conclusion.94

90. Id. at 814 n.34.
91. See U.C.C. § 1-102, comment 1.
93. For a similar implication, see R. BRAUCHER, DOCUMENTS OF TITLE 110 n.84, 111; Bascom, Articles 7 and 9 of the Uniform Commercial Code—Security Interests in the Warehouseman's Own Receipts Covering Fungibles, 1969 WASH. U.L.Q. 105, 135; cf., Note, 69 YALE L.J. 663, 703 (1960) (which poses the question).
94. “Under § 9-309 . . . Wagman would have prevailed if its warehouse receipt had
Section 9-309 is a purchase provision. It follows a series of provisions which insulate several categories of purchasers from the interest of a prior perfected secured party.\textsuperscript{95} In particular it provides that nothing in Article 9 "limits the rights of . . . a holder to whom a negotiable document of title has been duly negotiated"; that is, that nothing in Article 9 shall limit the rights of a qualified holder. The question remains, however, whether section 9-309 applies against a party whose rights arise before the document is issued. In both \textit{Hext} and \textit{Boody}, the interest of the party claiming against the holder arose prior to issuance of the document. In \textit{Boody} the document was a nonnegotiable warehouse receipt, and the arbitrator correctly ruled that section 7-503 does not apply to such a receipt.\textsuperscript{96} The \textit{Boody} opinion goes on to say, however, that had the receipt been negotiable, section 9-309 would have protected the qualified holder. The implication of this dictum, that Article 7 does not control the rights of a qualified holder, and the similar implication in \textit{Hext}, in which the receipt was negotiable, is troubling.

Article 9 is the fount of the secured party's rights.\textsuperscript{97} If, therefore, section 9-309 governs those situations where the interest of the secured party arises before issuance of the document, then, strictly speaking, such a secured party will always lose to the qualified holder. This result produces a direct conflict with the paramount rights rule of section 7-503. That provision expressly provides that the qualified holder will not defeat the rights of a person who "had a perfected security interest" in the goods before the issuance of the document.\textsuperscript{98} Admittedly, those paramount rights are subject to an estoppel exception; but the application of that exception is not automatic, and a person free of the estoppel's preclusion may assert those paramount rights against the qualified holder. In short, the \textit{Hext} and \textit{Boody} reading of section 9-309 suggests that the qualified holder always defeats the secured party, while section 7-503 clearly says that sometimes the prior secured party wins.

That conflict fades, however, if section 9-309 applies only to security interests arising contemporaneously with or after issuance of the document. Such a limitation of section 9-309 leaves the paramount rights rule room to operate when the interest of the party claiming par-

\textsuperscript{95} Sections 9-306, 9-307, 9-308 & 9-309 all contain provisions giving purchasers of various types of collateral protection against perfected security interests in that collateral.
\textsuperscript{96} See text accompanying notes 38-40 \textit{supra}.
\textsuperscript{97} \textit{See} U.C.C. §§ 9-101, 9-102, and comments thereto.
\textsuperscript{98} U.C.C. § 7-503(1).
amount rights arises "before issuance of the document." 99

Such a construction follows the traditional rule of statutory interpretation. Courts construe sections of the same statute in a fashion that renders them compatible. 100 In addition, and more convincingly, the purpose of section 9-309 supports this approach. The Code authorizes nonpossessory security interests in certain types of collateral that customarily move in commerce without title inquiry: instruments (negotiable instruments and securities), chattel paper, and negotiable documents of title. 101 These nonpossessory security rules accommodate the vagaries of financing this type of collateral and protect lenders against lien creditors. Such security interests, absent the rules of sections 9-308 and 9-309, would in themselves impose a severe restriction on the commercial acceptability of such collateral. They would force lenders and other purchasers to make time-consuming and costly title inquiries. 102 Sections 9-308 and 9-309 remove that burden by protecting buyers and creditors who take chattel paper, instruments, or negotiable documents in certain good-faith-purchase circumstances and who do not inquire about filings or other nonpossessory security interests. 103 The comments to both sections support this analysis. 104 The purpose of section 9-309, then, is to protect the qualified holder from nonpossessory security interests arising in the document under section 9-304(1). To extend its rule to situations where the security interest has arisen in the goods themselves prior to the issuance of a document covering the goods would violate a fundamental rule of Code construction 105 by go-

101. Section 9-304(1) permits perfection of a nonpossessory security interest in chattel paper or negotiable documents by filing in all instances. Subsections 9-304(4) and (5) permit perfection of nonpossessory security interests in instruments or negotiable documents without filing but in very narrow circumstances and for a period not exceeding 21 days in each case.
102. "Under § 9-304 a security interest in instruments or in goods covered by documents of title can be perfected, without possession or filing, for a 21-day period. This provision reflects a policy decision that the utility of such short-term interests in these types of collateral outweighs the 'secret lien' danger. If we accept the policy, it is a necessary corollary that the first party to get such an interest has priority over later comers, unless the later comers qualify as good faith purchasers under the rules applicable to negotiable and quasi-negotiable collateral." 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 34.5, at 912 (1965) (emphasis added).
103. Cf. U.C.C. § 7-602 (achieves similar protection for certain holders of warehouse receipts against lien creditors).
104. See U.C.C. § 9-308, comments 2 and 4; U.C.C. § 9-309, comment 2.
105. "The proper construction of the Act requires that its interpretation and application be limited to its reason." U.C.C. § 1-102, comment 1.
ing beyond the provision’s intended limit.\textsuperscript{106}

The reference in \textit{Hext} and \textit{Boody} to section 9-309, moreover, may support a rule different from the strict view criticized here. In providing that “nothing” in \textit{Article 9} limits the rights of a qualified holder, section 9-309 may mean to say that \textit{Article 7} governs those rights. \textit{Article 7} limits the rights of a qualified holder by the reference to a secured party in section 7-503. This reading of section 9-309 would not pose any conflict and is consistent with the view of this author that \textit{Article 7} governs the rights of the qualified holder. Clearly, courts should not infer from the \textit{Hext} and \textit{Boody} language any rule that the qualified holder always defeats the secured party.

\textit{Hendries’ Inc. v. American Express Co.}\textsuperscript{107} illustrates these issues in a different context. In \textit{Hendries} a bank issued a letter of credit and took negotiable receipts to secure advances it made under the credit. The facts of \textit{Hendries} indicate that the bank was a qualified holder. The bank’s customer, which had used the credit to buy the goods covered by the receipts, entered into contracts of sale with buyers who paid for the goods while they remained in the warehouse. The customer failed to pay the bank and, therefore, could not deliver the goods. The buyers sued the bank claiming that the good-faith-purchase rule of \textit{Article 9}, section 9-307(1), protected them. That provision would give the goods to a buyer in ordinary course free from the bank’s security interest.

The court rejected the argument. It held that the bank was a true owner, not a secured party, and that therefore section 9-307(1) did not apply. While the holding is consistent with the thesis advanced by this Article, the reasoning is not. Although it is true that a qualified holder takes title to the goods,\textsuperscript{108} \textit{Article 9} stipulates that its rules apply without regard to location of title. Section 9-102 provides that the form of the transaction does not matter. The critical fact is the existence of a transaction intended to create a security interest, a fact clearly present in the \textit{Hendries} case.

Nonetheless, the buyers in \textit{Hendries} should not be able to use section 9-307(1). Section 9-309 forbids the use of \textit{Article 9} rules to defeat

\textsuperscript{106} The \textit{Boody} opinion also suggests that § 9-309 does not affect the priority rule of § 9-312(5). Philadelphia Nat’l Bank v. Irving R. Boody, 1 U.C.C. Rep. Serv. 560, 565 (Arb. Dec. 1963) (Funk, Arb.). It is difficult to square that suggestion with the plain language of § 9-309, which permits “nothing” in Article 9, presumably § 9-312(5) included, to limit the rights of a qualified holder. \textit{See also} \textit{In re Fairfield Elevator Co.}, 14 U.C.C. Rep. Serv. 96, 105 (S.D. Iowa 1973).


\textsuperscript{108} U.C.C. § 7-502(1)(a)-(b).
the rights of a qualified holder.\textsuperscript{109} Article 7 is the proper source of those rights; and only to the extent that it defers to Article 9, as in section 7-503, does Article 9 play a role.

In brief, the courts have failed to utilize successfully the Code's scheme for enhancing the marketing and financing of goods through negotiable documents of title. That failure stems in large part from a misunderstanding of the proper role of estoppel in the legal treatment of qualified holders of such documents. A similar misunderstanding plagues the line of cases considering the rights of the nonqualified holder.

The Nonqualified Holder

By definition the qualified holder is one to whom a negotiable document has been duly negotiated. That definition leaves two types of nonqualified holder: persons who hold nonnegotiable documents and persons holding negotiable documents to whom the document is not duly negotiated. Section 7-504(1) defines the rights of both categories of nonqualified holders: "A transferee of a document, whether negotiable or nonnegotiable, to whom the document has been delivered but not duly negotiated, acquires the title and rights which his transferor had or had actual authority to convey."\textsuperscript{110} If the transferor has no title to the document and no \textit{actual} authority to convey title to it, the transferee gets nothing via the document whether the document is negotiable or nonnegotiable.

This rule contrasts sharply with the rules in sections 7-502 and 7-503, which go far in constructing a good-faith-purchase shield for the qualified holder. In section 7-504 situations that shield disappears for two reasons. First, the estoppel by deed implications of section 7-502 and \textit{Baldwin v. Childs}\textsuperscript{111} do not benefit the nonqualified holder. Second, section 7-503 does not apply in the nonqualified holder situation.\textsuperscript{112} Persons with rights paramount to those of the transferor always defeat the nonqualified holder under section 7-504; the estoppel benefits of section 7-503 do not extend to such a holder. Thus, for example, if a true owner or a secured party entrusts goods to a bailor with actual or apparent authority to store, and if that bailor stores the goods

\textsuperscript{109} Professor Skilton makes this point and discusses the \textit{Hendries} case. Skilton, \textit{Buyer in Ordinary Course of Business Under Article 9 of the Uniform Commercial Code (and Related Matters)}, 1974 Wis. L. Rev. 1, 49.

\textsuperscript{110} U.C.C. § 7-504(1).

\textsuperscript{111} 249 N.Y. 212, 163 N.E. 737 (1928). See note 20 \textit{supra}.

\textsuperscript{112} See text accompanying notes 38-40 \textit{supra}. 
against negotiable or nonnegotiable receipts and transfers the receipts to a nonqualified holder, the true owner or secured party will prevail if the holder is relying solely on the receipt.

The language of section 7-504 goes far enough, moreover, to prevent the nonqualified holder from asserting the principles of voidable title. That doctrine sanctions defeat of the true owner's rights by a good-faith purchaser who takes from one with voidable title. Thus, a true owner of goods who delivers them to a buyer while retaining the right to reclaim them because of the buyer's fraud nonetheless will lose to a good faith purchaser under the doctrine. Section 2-403(1), the good-faith-purchase provision of Article 2, applies this rule to sales of goods. Its first sentence, in words nearly identical to those of section 7-504, sets forth the umbrella rule for Article 2 that a purchaser takes what his transferor had or had "power to transfer." Section 2-403, however, goes on to adopt the voidable title doctrine by providing that the purchaser of goods also acquires good title even if the transferor had voidable title. In contrast, the Code drafters chose to reject the words "power to transfer" and not to incorporate any voidable title reference in section 7-504. That choice indicates that the doctrine has no place in commerce involving commodity paper.

The rule of section 7-504, then, is harsh and sometimes yields anomalous results. For example, negotiable documents generally enjoy a greater degree of negotiability than goods. A nonqualified holder holding a negotiable document of title, however, may have fewer rights than would result from dealing with the goods themselves. The good-faith-purchase rules of sections 9-307(1) and 2-403(2) apply to buyers of goods. Such benefits accrue to the nonqualified holder only if the holder attains the status of a buyer in ordinary course. Similarly, a consignee of a nonnegotiable bill of lading may have greater rights under section 7-504(1) than the nonqualified holder of a negotiable bill of lading. If the consignee's transferor had title or actual authority to convey title, the consignee would receive good title. Yet, the transferee of a negotiable document who cannot satisfy the require-

113. See Warren, supra note 2, at 475.
116. U.C.C. § 2-403(1).
117. See Warren, supra note 2, at 484. Professor Warren suggests that the notion that goods are negotiable is at a "more rudimentary stage of development." Id.
118. See U.C.C. § 7-504, comment 1.
ments of section 9-307(1) or section 2-403(2) and whose transferor did not have title or actual authority would not have good title.

A nonqualified holder can satisfy the Article 2 and Article 9 rules only if such holder is a buyer in ordinary course, which perforce requires establishing oneself in the role of buyer. Sometimes nonqualified holders will be buyers. At times, however, they are only purchasers. This distinction between buyers and purchasers parallels the two roles documents of title serve: marketing and financing. The concept of buyer in ordinary course is a marketing concept. The concept of purchase is broader and includes taking by mortgage, pledge, or lien. A lender may rise to the status of a good-faith purchaser but cannot rise to the level of a buyer in ordinary course, because a lender does not buy out of inventory in the marketing sense of the buyer-in-ordinary-course definition. Thus, it is the lender who is most likely to fall victim to section 7-504. If the lender is not a qualified holder, by definition, that lender will not benefit from the good-faith-purchase rule of Article 7; similarly, the lender will be unable to seek refuge in the buyer-in-ordinary-course rules of Articles 2 and 9. The justification for this rather harsh treatment lies in the deference Article 7 accords the concept of “due negotiation” and its willingness to pay the price for protection of regular dealings with negotiable documents of title by refusing to accord any estoppel or voidable title benefits to dealings which are irregular.

In addition to voidable title and estoppel, waiver is a third common-law doctrine that may defeat rights of prior parties. Certainly there is nothing in Article 7 to prevent a nonqualified holder from arguing that a true owner or secured party expressly waived its rights to assert an ownership or security interest against the nonqualified holder. This waiver gives the transferor “actual authority” to convey the document to the holder free of such interest. To hold, however, that any conduct of the true owner or secured party constitutes implied waiver of those rights is an entirely different matter. As with other common-law and equitable doctrines, the doctrine of implied waiver supplements the Code “[u]nless displaced by [its] particular provisions.”

119. See U.C.C. § 1-201(9).
120. See U.C.C. § 1-201(32).
122. See U.C.C. § 7-503.
123. U.C.C. § 7-504, comment 1.
124. U.C.C. § 1-103. In determining the extent to which the Code displaces such older principles, commercial lawyers must of course be mindful of the Code's role calling for
Implied waiver serves significant purposes in the Code. Both Article 2125 and cases construing Article 9126 employ it to defeat rights of true owners and of secured parties in certain instances. Section 1-205 suggests that courts can infer waiver from a course of dealing or trade usage in any Code transaction, including one involving documents of title.

The general rule governing the application of implied waiver, both at common law and under the Code, contains an important limitation. Only those parties dealing with the party from whose conduct waiver is to be inferred may benefit from such waiver.127 In this respect implied waiver resembles estoppel, and the clear policy of Article 7 against invoking estoppel to benefit nonqualified holders is the first argument against permitting the use of implied waiver in a similar fashion. To the extent that the nonqualified holder deals with the true owner or secured party, that holder does not need the benefit of the implied-waiver doctrine. In such cases the transferor will have conveyed to the nonqualified holder all of the ownership or security interest. It is only in third party situations that these conveyancing rules become important, and in those situations a nonqualified holder would not be dealing with the true owner or secured party and implied waiver is, therefore, inapplicable.

Some courts use an expansive interpretation of section 9-306(2) to fashion an exception to the general rule.128 That section provides that waiver of the condition against disposition of the collateral constitutes waiver of the security interest in the collateral. The cases finding implied waiver permit buyers who have never dealt with the secured party to benefit from the secured party's conduct which has reasonably led not the buyer but the buyer's transferor to believe that the sale is au-

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125. See U.C.C. §§ 2-208(3), 2-209(5). See also U.C.C. § 2-208, comment 3.
This exception arises, however, only because the statute leaves room for it, and the statute only operates against secured parties.\footnote{\textsuperscript{131}}

In short, the nonqualified holder finds narrow support in the supplemental rules of the common law or in the Code itself for the position that such holder should take anything more than that which section 7-504 provides: the interest which the transferor had or had actual authority to convey. Thus, the substantial difference in treatment accorded by the Code to qualified and nonqualified holders should be apparent. Yet cases dealing with nonqualified holders often stumble over these distinctions.

In \textit{Cleveland v. McNabb},\footnote{\textsuperscript{132}} for example, the court found that the Commodity Credit Corporation took the warehouse receipts with notice of defenses and therefore did not rise to the status of a qualified holder. Although the court’s finding may be subject to criticism, all estoppel inquiry must necessarily end when the court determined that the party was not a qualified holder. As a lender rather than a buyer, the corporation could not benefit from the estoppel rules of Articles 2 or 9; nor should it have been able to benefit from the estoppel rule of Article 7 because that rule applies only to qualified holders.\footnote{\textsuperscript{133}} Nonetheless, when the Commodity Credit Corporation raised an estoppel argument, admittedly in the context of common-law estoppel rather than as an adjunct to its claim of the rights of a qualified holder, the \textit{Cleveland} court ignored these distinctions. Instead, the court evaluated and rejected the argument, not because the corporation was a nonqualified holder nor because it was not a buyer in ordinary course, but on the grounds that the Tennessee crop-lien statute did not contemplate an estoppel exception.

Since the corporation could not enjoy estoppel rights by virtue of its position as a nonqualified holder,\footnote{\textsuperscript{134}} its estoppel argument must presuppose that it enjoyed rights as a purchaser of the goods. Such a pre-
sumption runs directly counter to the Code's carefully drawn distinction between qualified and nonqualified holders. It is the qualified holder who receives an interest in the goods by virtue of the transaction\textsuperscript{135} and who benefits from good-faith-purchase estoppel rules referred to in the qualified-holder section.\textsuperscript{136} The nonqualified holder obtains only what the transferor had or had actual authority to convey.\textsuperscript{137} The corporation's argument, therefore, positioned the cart before the horse by assuming that its rights in the goods gave it the power to invoke estoppel. Under section 7-504 the corporation had rights in the goods only if its transferor had such rights or had actual authority to convey such rights. The corporation, being neither a buyer nor a qualified holder, cannot benefit from estoppel.

In Branch Banking and Trust Co. v. Gill,\textsuperscript{138} the Supreme Court of North Carolina, in an opinion withdrawn two years later, went further than the Cleveland court and actually invoked estoppel to aid a lender which was a nonqualified holder. The lending bank held sixteen negotiable warehouse receipts issued by an elevator to the bank's debtor which were then pledged by that debtor to secure loan advances made by the bank. One Woodcock was both local manager of the elevator and secretary-treasurer of the borrower. As part of a scheme to cover elevator shortages, he caused thirteen new receipts to be issued to the borrower and delivered them to the bank which, upon receiving them, surrendered the original sixteen receipts. The bank's note teller did not realize until after Woodcock left the bank that the borrower had not endorsed the thirteen new receipts. Consequently, the court properly held that the bank was not a qualified holder. Even though the receipts were negotiable, they had not been duly negotiated to the bank.\textsuperscript{139} Accordingly, the court observed, "the Bank has no greater right by virtue of these receipts than did [the borrower]."\textsuperscript{140}

Notwithstanding that conclusion, the court went on to hold that because the benefit from the fraud accrued to the elevator, rather than the borrower, the elevator "cannot now be heard to deny [the] validity"

\textsuperscript{135} "[A] holder to whom a negotiable document of title has been duly negotiated acquires thereby . . . title to the goods . . . ." U.C.C. § 7-502(1).

\textsuperscript{136} See notes 29-42 and accompanying text supra.

\textsuperscript{137} See note 110 and accompanying text supra.


\textsuperscript{139} See U.C.C. § 7-501(1).

\textsuperscript{140} 286 N.C. 342, 357, 211 S.E.2d 327, 338 (1975).
of the receipts.\textsuperscript{141} Thus, the court estopped the elevator. The court saw the bank as the less culpable party and sought to impose liability upon Woodcock, the surety on his bond, and the elevator.\textsuperscript{142} Liability, however, would have attached under section 7-203.\textsuperscript{143} It was unnecessary for the court to rely on the estoppel ruling to gain the equitable result.\textsuperscript{144} In fact, more than two years after deciding the \textit{Branch Banking} case the Supreme Court of North Carolina “withdrew” its opinion and rendered a decision which holds that section 7-203 and not section 7-504 governs the result.\textsuperscript{145} Significantly, the court did not correct the misimpressions of its earlier opinion, even though it is clear that counsel had argued the point on rehearing.\textsuperscript{146} The court thereby let stand the same error made by the \textit{Cleveland} court: application of estoppel or similar rules for the benefit of a nonqualified holder to whom the Code explicitly denies such relief.

In \textit{Lofton v. Mooney}\textsuperscript{147} the Supreme Court of Kentucky pursued a similar course of disregarding the distinction between the qualified and nonqualified holder. In \textit{Lofton}, farmers delivered their grain to a mill, with part to be stored and part to be purchased under contract with the

\textsuperscript{141} \textit{Id.} at 360, 211 S.E.2d at 339.

\textsuperscript{142} In his dissent to the North Carolina Supreme Court’s subsequent opinion in the \textit{Branch Banking} case, one justice disputes the conclusion that the holding amounts to an estoppel. On rehearing, counsel for the defendants argued, as this Article does, that § 7-504 denies estoppel benefits to the nonqualified holder. The dissenter rejected the contention, arguing that the court’s earlier decision amounted to an application not of the equitable doctrine of estoppel but of the common law doctrine of ratification. That distinction, however, begs the question, which is whether the court gave the nonqualified holder, who claims rights to goods under an instrument, greater rights than his transferor had or had actual authority to convey. The court’s holding gave the bank greater rights than its transferor had. It matters not whether the court bottoms its holding on estoppel, voidable title, implied waiver or ratification. See text accompanying notes 111-30 supra.

\textsuperscript{143} “A . . . purchaser for value in good faith of a document of title other than a bill of lading relying . . . upon the description therein of the goods may recover from the issuer damages caused by the non-receipt . . . of the goods . . . .” U.C.C. § 7-203. A nonqualified holder may qualify as a purchaser for value in good faith. See U.C.C. §§ 1-201(32), 1-201(33). The lack of an indorsement would not defeat the bank’s claim under § 7-203. In fact the borrower later supplied the indorsement but at a time when the bank knew of the defense. That notice would not alter the bank’s right to sue the elevator under § 7-203 for nondelivery. See Proctor & Gamble Distrib. Co. v. Lawrence Am. Field Warehousing Corp., 16 N.Y.2d 344, 213 N.E.2d 873, 266 N.Y.S.2d 785 (1965) (warehouse liable for failure to deliver commodity it actually received).

\textsuperscript{144} Significantly, § 7-203 does not excuse the liability of the elevator where, as in \textit{Branch Banking}, the agent issues the receipt without authorization from his warehouse principal. See U.C.C. § 7-203, comment.


\textsuperscript{146} 237 S.E.2d at 38 (dissent).

\textsuperscript{147} 452 S.W.2d 617 (Ky. 1970).
Both the pleadings and the fact situation were confusing, but it appears that a double bailment was involved.

The mill, needing financing, entered into a field-warehouse arrangement whereby it rebailed the grain with the field warehouse which issued a nonnegotiable receipt directly to the mill's bank. Apparently, the grain subject to the field-warehouse receipt included both grain delivered for storage and grain delivered pursuant to the purchase contracts with the mill. The farmers sued the mill for sums due on the purchase contracts, obtained a judgment, and levied on the grain in the field warehouse. The bank claimed superior rights. The farmers, in turn, sued the bank for sums paid to it, purportedly out of proceeds from earlier sales of their grain other than that subject to the attachment levy.

The court regards the case, at its simplest level, as a dispute between a lien creditor and a secured party. Assuming that there was an underlying security agreement between the bank and the debtor, the bank perfected its security interest by having the nonnegotiable receipts issued in its name. That perfection, it appears from the facts of the case, antedated attachment by the farmers, and the perfected, secured party, therefore, prevailed under general Code rules. The pleadings of the Lofton case may well justify that result, but it is clear from the arguments raised by counsel and considered by the court that the farmers attempted to assert paramount rights and thereby to overcome the general priority rule that a perfected secured party will defeat a lien creditor.

First the bank argued that section 7-503 applied and that the esstoppel rule of that section defeated the farmers. The court agreed that the farmers had delivered the grain to the mill which had "apparent, if not actual, authority to sell;" but the court noted that the farmers were not asserting prior, paramount rights. The farmers claimed rights under their attachment, which arose after issuance of the receipt.

148. "As the chancellor observed in an understatement, the pleadings in this case are 'rather confusing.'" Id. at 618.
149. U.C.C. § 9-304(3).
150. See U.C.C. §§ 9-201, 9-301(1)(b).
151. Lofton v. Mooney, 452 S.W.2d 617, 619 (Ky. 1970). The court's choice of language reveals its error. Indeed, the entrustment by the farmer to the elevator did give authority to sell; and had the elevator sold by negotiable receipt, nonnegotiable receipt, or delivery of the grain, a buyer in ordinary course or qualified holder would defeat the farmer. See U.C.C. §§ 7-205, 7-503, 9-307(1). Though the bank is a purchaser, it is neither a buyer nor a qualified holder (U.C.C. § 1-201(32)-(33)). The elevator did not sell grain, but rather, pledged it. The court is engaging in the same circular reasoning which characterized the Branch Banking opinion. See text accompanying notes 138-44 supra.
Clearly the farmers did enjoy prior, paramount rights in that portion of the grain they delivered for storage. The bank, moreover, was not entitled to use the estoppel rule of section 7-503 as to that corn. The bank was not a qualified holder. It held a nonnegotiable receipt.

Section 7-504 should have governed the rights of the bank. The plaintiff farmers in the Lofton case argued that the bank's rights under that provision were subordinate to those of the true owners. The court, however, refused to apply section 7-504, reasoning that the section applies only to "transferees." The bank was not a transferee but an issuee. The warehouse issued the receipts directly to the bank. Thus, the court found that neither of the transfer provisions of Article 7 applied to the bank: section 7-502 was inapplicable because of estoppel and section 7-504 was inapplicable because the bank was an issuee. Consequently, the court found itself with no authority in Article 7 to determine the rights of the bank. To resolve its dilemma it concluded, without citing any authority, that the bank "stands in the shoes of a good faith purchaser for value." 

That resolution exposes the court's basic misunderstanding of the doctrine of good faith purchase in documentary transactions. Since this bank held nonnegotiable receipts and was not a buyer, its rights must arise under Article 7. First, section 7-502 and section 7-504 make it clear that of all persons who claim rights under documents of title, only the qualified holder may use estoppel. Second, Article 7 classifies persons claiming rights under documents of title into only two classes: those who are qualified holders and those who are not. Section 7-502 governs the rights of the first class and section 7-504 governs the rights of the second. The Lofton court creates a third class, those whose rights are governed by some obscure pre- or non-Code notion. By excluding an issuee from the class of transferees, the court creates a gap in the coverage of Article 7 contrary to the rule requiring liberal construction of Code provisions.

There are two ways in which field-warehouse financing can proceed. Either the field warehouse can issue the receipts to its bailor (in

152. In fact, it did not apply because the receipts were nonnegotiable.
154. See U.C.C. § 1-102. In this regard Professor Gilmore takes a strong position. He argues that it would be "absurd" to suggest that the result turn on the fact of whether the field warehouse issues the receipt to the bailor who, in turn, "transfers" to the bank or whether the field warehouse issues the receipt directly to the bank. G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 6.6, at 173 n.6 (1965); cf. U.C.C. § 1-201(20) (Code defines "holder" to include an issuee); U.C.C. § 7-203 (extending protection against a bailee's nonreceipt or misdescription to issuees as well as transferees).
Lofton, the mill) and the bailor can transfer them to the bank, or the warehouse can issue the receipts directly to the bank. The form of the transaction should not matter. In either event, section 7-504 should govern, and the rights of the bank should be measured by the rights of the bailor. In Lofton, then, the bank could receive only those interests the mill had in the grain or had actual authority to convey. The mill had no rights in the grain stored and no actual authority to grant the bank a security interest in it. The bank, therefore, took no interest in that grain. With respect to the grain the farmers had sold to the elevator, however, the bank took free of the true owners' interest.¹⁵⁵

Although other decisions demonstrate a greater degree of adherence to the distinction between qualified and nonqualified holders, the decisions themselves are not entirely helpful. The court's conclusion seems almost accidental in one of them and in the second the course of the decision raises troubling questions.

Citizens Bank & Trust Co. v. SLT Warehouse Co.¹⁵⁶ reflects a more loyal disposition toward the distinctions of Article 7 between negotiable and nonnegotiable receipts. The facts of Citizens Bank parallel those of Lofton. The farmers "entrusted"¹⁵⁷ their grain to an elevator, which in turn entered into a field-warehousing arrangement with the defendant. The defendant field warehouse issued nonnegotiable receipts to the elevator rather than directly to the bank, and the elevator transferred them to the plaintiff bank. The court ruled first, that the bank could not defeat the rights of the farmers, and second, that delivery of the grain to the farmers would have absolved the field warehouse from liability.¹⁵⁸

Article 7 supports both rulings. First, although the court did not directly refer to it, the entrustment of the grain by the farmers did not benefit the bank. While the entrustment might have precluded the farmers from asserting their paramount rights against a qualified holder under section 7-503(1)(a) or (b), it did not affect the farmers' rights against the bank, which held nonnegotiable receipts and therefore was a nonqualified holder. Second, section 7-403 explicitly absolves from liability a warehouse that delivers commodities to one

¹⁵⁶ 368 F. Supp. 1042 (M.D. Ga. 1974), aff'd per curiam, 515 F.2d 1382 (5th Cir. 1975).
¹⁵⁷ Id. at 1043.
¹⁵⁸ In fact, the elevator had surreptitiously returned the grain without the knowledge of the field warehouse or the bank. Id. at 1044-45.
whose rights are superior to those of the party holding the receipt. In this case the farmers enjoyed such superior rights; therefore, delivery to them should have left the bank (a nonqualified holder) with no rights against the warehouse.

There is no discussion of estoppel in the *Citizens Bank* opinion, and it may be that the litigants did not raise the issue. The case then does not serve as authority for the distinctions this paper posits, but rather as an illustration of them. Had the receipts to the Citizens Bank been negotiable and the bank a qualified holder, an estoppel inquiry would have governed the outcome. If the farmers had "entrusted" in a fashion that precluded them from asserting their paramount rights against the bank, delivery to the farmers would have been wrongful.159

In *Midland Bean Co. v. Farmers State Bank*,160 a court seemingly understood these distinctions and ruled in favor of the true owners and against the nonqualified holder. In other respects, however, the *Midland* opinion raises questions. The plaintiff in that case purchased beans by drawing nonnegotiable "drafts" on the elevator. The elevator, in turn, accepted those "drafts."161 The court held that the accepted drafts were documents of title and that section 7-504 governed the rights of the purchaser because the drafts were nonnegotiable. To this extent the court's opinion finds support in Article 7. Such drafts are in the nature of delivery orders162 and their acceptance by the warehouse renders them "for practical purposes indistinguishable from a warehouse receipt."163

The first troubling feature of the *Midland* holding arises out of the timing. The opinion recites that the elevator accepted the drafts over a period extending from September, 1971 to May, 1972. On January 4, 1972 the elevator acquired beans by taking a warehouse receipt from one Lundock.164 Although the opinion does not disclose whether this

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161. The opinion indicates that the elevator "endorsed" the draft. *Id.* at 319. Presumably it endorsed the check which accompanied the drafts and "accepted" the drafts. It could then fill the orders from time to time pursuant to the delivery dates in the drafts.
162. "'Delivery order' means a written order to deliver goods directed to a warehouseman . . . ." U.C.C. § 7-102(1)(d) (emphasis added).
163. U.C.C. § 7-102, comment 3.
164. The opinion follows the disconcerting practice of referring to these transactions and documents in terms of the underlying commodity. It says that plaintiff "bought" beans from the elevator and that the elevator "purchased" beans from Lundock. *Midland Bean Co. v. Farmers State Bank*, 552 P.2d 317, 319, 321 (Colo. App. 1976). Whether, in fact, plaintiff "bought" anything other than a nonnegotiable document of title and whether the elevator "purchased" anything other than a warehouse receipt, depends on facts not recited
receipt, issued by a grain company, was negotiable or nonnegotiable, the court concluded that the elevator had title to the Lundock beans. "[I]t follows that Brush Elevator could convey full rights in the 'Lundock' beans to [plaintiff]."\(^{165}\) In fact, that conclusion follows only if the nonnegotiable drafts upon which the plaintiff relied were accepted after the elevator acquired an interest in the Lundock beans, a fact the court nowhere recites. If it had been true that the elevator possessed no beans to "fill" the drafts when it accepted them, the Midland holding would then permit the subsequent purchase by the elevator to "feed" the earlier drafts. Such a holding amounts quite simply to an application of the Baldwin v. Childs rule of estoppel by deed. That estoppel rule should apply only in favor of a negotiable document of title.\(^{166}\) Midland, then, is the most recent case supporting what is fast becoming a majority rule,\(^{167}\) which largely ignores or misunderstands the basic disparity between qualified and nonqualified holders and which fails to recognize that the application of estoppel principles is proper in regard to the former and not to the latter.

The Interplay of Articles 7 and 9 with Respect to Nonqualified Holders

The second problem with the Midland decision relates to the interaction of Articles 7 and 9. After concluding that Midland, the buyer, acquired an interest in the Lundock beans, the Midland court then had to resolve a dispute between Midland and the elevator's bank which had obtained a security interest in all of the elevator's assets. As in Branch Banking, the court issued an opinion and subsequently withdrew it. In its original opinion,\(^{168}\) the court concluded that the bank was unperfected as to the Lundock beans and, therefore, the plaintiff prevailed since it had "title" to the beans when it took the nonnegoti-

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\(^{165}\) Id. at 322.

\(^{166}\) See U.C.C. § 7-502(1)(c) and comment 2. See text accompanying notes 111-18 supra.

\(^{167}\) In fact, none of the cases which consider these estoppel rules makes the distinction the drafters of Article 7 took such pains to define, though there are cases which recognize that § 7-503 does not apply to nonnegotiable documents. See Citizens Bank and Trust Co. v. SLT Warehouse Co., 368 F. Supp. 1042, 1048 (M.D. Ga. 1974), aff'd per curiam, 515 F.2d 1382 (5th Cir. 1975); Douglas-Guardian Warehouse Corp. v. Esslair Endsley Co., 10 U.C.C. Rep. Serv. 176, 190 (W.D. Mich. 1971); Philadelphia Nat'l Bank v. Irving R. Boody Co., 1 U.C.C. Rep. Serv. 560, 568-69 (Arb. Dec. 1963) (Funk, Arb.).

able "drafts" from the elevator. Yet it is not necessary under either Article 7 or Article 9 for a secured party to perfect in order to defeat Midland. Under section 9-301(1)(c), by implication, a buyer of goods or documents loses to an unperfected secured party unless the buyer is either a buyer in ordinary course or has received delivery of the collateral. The court did not find that plaintiff was a buyer in ordinary course, although this might well have been the case. Yet without that finding, there is nothing left on which the court can base its ruling for the plaintiff, since plaintiff had not received delivery of the beans. In short, section 7-504 should govern, because the only rights the plaintiff acquired under the nonnegotiable "drafts" were rights which its transferor had or had actual authority to convey. Here, the interest of the transferor (the elevator) taken by the plaintiff is an interest subject to the security interest of the bank. In sum, the Midland court's original opinion fashioned a rule which complies with neither Article 7 nor 9, both of which consistently call for a decision against the plaintiff unless it establishes itself as a buyer in ordinary course.

When the Midland court originally concluded that the bank was

169. Id. at 177.
170. Clearly, the bank would defeat Midland if the bank were a perfected secured party and Midland were not. See U.C.C. §§ 7-504(1), 9-201. Midland is not a secured party, since the elevator did not sign a written security agreement granting Midland a security interest in the Lundock beans. The mere issuance of a nonnegotiable receipt in the name of Midland is not enough to create a security interest. See note 181 infra.
171. The opinion does not explain its conclusion that the bank was unperfected. If the receipt covering the Lundock Beans was a negotiable receipt, the bank may well have been perfected. Section 9-304(1) provides that a security interest in a negotiable document of title may be perfected by filing, and the bank had filed. Similarly, if the receipt were nonnegotiable, § 9-304(3) provides that a security interest in the goods may be perfected by filing as to the goods themselves or by notification to the bailee. The key to perfected status, then, is the description of the collateral in the security agreement and the filed financing statement. If those descriptions had been sufficient to cover all assets of the elevator, including negotiable documents of title and beans covered by nonnegotiable documents of title, or if the bailee grain company had been notified, the bank would have been perfected.
172. Cf. U.C.C. § 9-307(1) (buyer in ordinary course defeats security interest created by the seller).
173. Cf. U.C.C. § 7-205 (buyer in ordinary course of fungible goods from warehouse defects person claiming under warehouse receipt if the goods have been delivered).
174. The Code's use of the term "collateral" makes it clear that it is delivery of the beans and not the document which is the critical delivery. The bank's collateral consisted of beans, not the accepted "drafts" of which the bank had no knowledge.
175. Indeed, the plaintiff's seller had not received delivery of the beans, which, presumably, were still in the elevator that had issued the receipt to Lundock. The plaintiff's seller had received only a receipt covering the Lundock beans.
176. See U.C.C. § 9-201.
unperfected, it appears to have assumed that the parties' rights should be measured sometime after the elevator defaulted. In fact, the elevator signed the draft upon which the plaintiff based its claim between September 4, 1971 and May 4, 1972. The bank took its security interest on May 10, 1972. The court's modified opinion reasoned that at the time the elevator accepted the draft and thereby transferred its interest in the beans to plaintiff, the bank had no security interest at all. In that event, under section 7-504, the plaintiff took what its transferor had at the time of transfer, beans free from the security interest.

Nothing in Article 9 disturbs that result. The difficulty with the second opinion lies in the fact, alluded to above, that the court does not make it clear whether the elevator had any interest in the Lundock beans when it accepted the draft. The court, therefore, leaves itself open to the criticism that it was invoking the Baldwin v. Childs estoppel by deed rule improperly, that is, in favor of a nonqualified holder. Thus, the modified opinion fails to correct the misimpression, created by the original decision, that the buyer of a nonnegotiable document of title takes priority over an unperfected secured party.

The nettlesome question of whether Article 7 or 9 is the source of a nonqualified holder's rights in disputes with a secured party has been raised by two additional cases. In Philadelphia National Bank v. Irving R. Boody Co., the arbitrator took the position that those rights emanate from Article 9 and concluded that Articles 9 and 7 would yield the same results in any event. Boody, a secured party, asserted that its security interest should prevail, under the terms of section 9-312(5)(b), over the rights of Wagman, a nonqualified holder who also claimed a security interest.

Both Boody and the nonqualified holder had extended credit to the debtor with the expectation of obtaining a secur-

179. Id. at 565-66.
181. The opinion recites that the nonqualified holder obtained its rights by "pledge" of the nonnegotiable receipt. Philadelphia Nat'l Bank v. Irving R. Boody Co., 1 U.C.C. Rep. Serv. 560, 564 (Arb. Dec. 1963) (Funk, Arb.). In fact the parties by stipulation had framed the issue in terms of the rights of a "bona fide pledgee." Id. at 563. Some authorities question the notion that a nonnegotiable receipt can be the subject of a pledge. See R. Speidel, R. Summers & J. White, Teaching Materials on Commercial and Consumer Law 204-05 (2d ed. 1974). That objection, which the cited authors carry over to negotiable documents of title as well, is theoretical in origin. It posits the idea that since the lender does not have possession of the goods, the transfer which effects the security interest
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ity interest in certain wool. After granting a security interest to Boody, the debtor bailed the wool and caused a nonnegotiable receipt to be issued to Wagman. Under the rules of Article 9 both parties, then, could claim the status of a perfected secured party. Boody's security interest arose out of a written security agreement and filed financing statement. Presumably, Wagman also had a written security agreement and had perfected his security interest pursuant to section 9-304(3) by having the nonnegotiable receipt issued in his name. The arbitrator concluded that the priority rules of Article 9 controlled.

does not meet the *sine qua non* of a classic pledge. In the classic pledge it is the deprivation by the secured party of possession by the debtor which prevents the debtor from creating interests in others, be they buyers or creditors. *Id.* These observations are not academic fancy. They highlight, especially in the nonnegotiable receipt situation, the fact that the rights of the so-called pledgee of a document of title derive not from possession of the goods but from rights in the document. Rights under a document of title, however, depend on the rules of Article 7, not the pledge rules of Article 9 or pre-Code common law. Under the rules of Article 9, furthermore, it is risky to speak of “pledging” a nonnegotiable document of title. Article 9 permits the pledgee to rely on its possession pursuant to an oral agreement as a method of creating his security interest. U.C.C. § 9-203(1)(a). If the “pledgee” does not possess the collateral, however, the pledgee must obtain a written security agreement. *Id.* The provisions of § 9-304(3) which relate to perfection of a security interest in goods covered by a nonnegotiable document do not obviate the necessity of a written security agreement absent possession of the goods. In fact, they do not even suggest that possession of a nonnegotiable document can serve to perfect the security interest, let alone create it. Professor Gilmore suggests, however, that in the realm of field warehousing, “there is no reason why delivery of the [nonnegotiable] receipts by warehouseman to lender should not constitute a good pledge.” 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 1.4, at 20 (1965). He would accord similar treatment to nonnegotiable receipts covering distilled spirits and issued pursuant to federal statute. *Id.*

These suggestions by Professor Gilmore may well be the Code rule. The Code sanctions possession by an agent. Sections 9-304(3) and 7-504(2)(b) recognize that the identity of the bailee's principal may change without delivery of the goods themselves. Thus, for example, if a bailor transfers his interest in the goods by a nonnegotiable document to a transferee and notifies the bailee of the transfer, the Code deems the transferee to have possession of the goods. § 9-304(3). The bailee has become the agent of and holds the goods for the transferee. It makes sense to extend that concept of possession by an agent not only to purposes of the perfection requirement of § 9-304(3) but also to purposes of the pledge rule of § 9-203. See note 182 infra.

182. The arbitrator's opinion recites: “Wagman obtained a perfected security interest by the pledge to it of a nonnegotiable warehouse receipt for the wool, issued in its name.” Philadelphia Nat'l Bank v. Irving R. Boody & Co., 1 U.C.C. Rep. Serv. 560, 564 (Arb. Dec. 1963) (Funk, Arb.). The stipulation of fact in Boody supports that conclusion. *Id.* at 562-63. If Wagman did not have a written security agreement he would still be a secured party. See note 181 supra. The issuance of the nonnegotiable receipt to Wagman presupposes notice to the bailee. Wagman’s position, then, is superior to that of Midland in the Midland Bean Co. case. See notes 160-177 supra. Midland, not being a secured party, is subject to the negative implication rule of § 9-301(1)(c) and thus loses to an unperfected secured party. Wagman, by virtue of his secured status, escapes this fate. See note 171 supra.

and held that section 9-312, the provision which governs disputes between perfected secured parties, dictated a result for Boody.\textsuperscript{184}

Analysis of this dispute under Article 7 reveals the same result. Wagman, as a nonqualified holder, obtains only those rights which his transferor, the debtor, had in the wool or had actual authority to convey.\textsuperscript{185} The debtor's rights in the wool were subject to Boody's security interest. Wagman, therefore, took subject to that interest. The arbitrator, however, rested his decision entirely upon Article 9; he was not faced with any potential conflict with Article 7, having correctly concluded that Articles 7 and 9 were compatible under these facts. In a subsequent decision\textsuperscript{186} a federal district court followed Boody, holding that Article 9 alone governs priority disputes between two parties claiming a security interest.

The difficulty with the general view expressed in the Boody case lies in the fact that Article 7 and section 9-312 do not always yield the same result. The priority rules shift in one direction when the transferee of a nonnegotiable receipt is a buyer, and in another when the transferee is a lender. Under the rules of section 9-312(5), as amended in 1972, if Boody had filed its financing statement prior to the time the debtor signed a security agreement granting Boody a security interest in the wool and if Wagman had meanwhile acquired the receipts, thereby perfecting his security interest before Boody's security interest attached,\textsuperscript{187} section 9-312 would effect one result and Article 7 another. Under section 9-312(5)(a), Boody, having filed before Wagman perfected, would have priority. Under Article 7, however, Wagman, being the transferee of a nonnegotiable receipt, would take what the debtor, his transferor, had, namely title to the wool unencumbered by Boody's security interest, which had not yet attached.\textsuperscript{188} Concededly, this conflict arises in a narrow situation, and under facts different from

\begin{itemize}
\item \textsuperscript{184} Under U.C.C. § 9-312(5)(b) (1962 version) if there are two perfected secured parties, unless they both perfect by filing, the first to perfect has priority.
\item \textsuperscript{185} U.C.C. § 7-504.
\item \textsuperscript{187} Under the assumed facts, Boody's security interest could not attach until Boody had given value, the debtor had an interest in the collateral and the security agreement was signed. U.C.C. § 9-203.
\item \textsuperscript{188} Under this hypothetical the security interest would not attach until Boody has given value and obtained the debtor's signature on a written security agreement describing the collateral. See U.C.C. § 9-203(2).
\end{itemize}
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those of Boody; it nonetheless, supports the view that Article 7 and Article 9 do not always provide the same answer.

The illustration, moreover, suggests an alternative approach for resolving any potential conflict between the two articles. Given the hypothetical modification of the Boody facts, i.e., that Wagman takes the nonnegotiable receipt after the time Boody filed but before Boody's security interest attaches, assume additionally that Wagman is not a lender but a buyer of the wool. He buys not by taking delivery of the wool, but rather by having the owner deliver a nonnegotiable receipt.

Article 9 fashions protection for purchasers of goods in a number of provisions: sections 9-301(1)(c); 9-306(2); and 9-307(1). The first protects those buyers who are not buyers in the ordinary course against unperfected secured parties; the second protects buyers when the secured party authorizes the sale; the third protects buyers in ordinary course. The second and third provisions clearly do not protect Wagman, because the hypothetical posits neither authority for the secured party to sell nor buyer in ordinary course status for Wagman. Section 9-301(1)(c) is the only other provision which might apply, yet Wagman also fails to qualify for its shelter. First, the section purports to protect buyers against a secured party. In the hypothetical, Boody does not become a secured party until after Wagman takes the receipt. If, however, Wagman could defeat a secured party, he should be able to defeat an unsecured party. Given that reasonable implication in section 9-301(1)(c), Wagman still fails to come within its terms, which apply only if he has taken delivery of the "collateral." Boody's col-

189. A recent New York decision holds that such a buyer may qualify for buyer in ordinary course status and that the fact that the goods are not delivered poses no obstacle to that determination. See Tanbro Fabrics Corp. v. Deering Milliken, Inc., 39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976).

190. Clearly, the nonnegotiable document received by Wagman cannot satisfy the delivery requirement of the section. Delivery of a nonnegotiable receipt does not operate as delivery of the goods. Compare U.C.C. §§ 7-502(1), 9-304(1) & (2) with U.C.C. §§ 7-504, 9-304(3). This conclusion appears at first blush to conflict with comment 4 to § 9-301. That comment suggests that delivery of a document of title is sufficient delivery. Significantly, however, both the comment and the section refer to delivery of "collateral." A nonnegotiable document is not "collateral" for the reasons set forth in note 181 supra. Only negotiable documents of title can serve as "collateral." In addition, the term "collateral" must refer to the property in which the unperfected secured party claims a security interest. In the Boody case, Boody claimed no security interest in the document of title held by Wagman. Boody claimed a security interest in the wool, and if Boody had been unperfected, as the hypothetical assumes, only delivery of the wool (Boody's collateral) would defeat Boody under the terms of § 9-301(1)(c). Similarly, a buyer in ordinary course may defeat a transferee but he must notify the bailee or be able to say that he has taken delivery of the goods. U.C.C. § 7-504(2)(b).
lateral consists of the wool, and Wagman did not take delivery of the wool. Article 9, then, yields nothing to protect this hypothetical Wagman.

Section 9-201, however, does not limit protection of purchasers to Article 9. It extends the effect of the security agreement to purchasers except “as otherwise provided by this Act.” The Act provides otherwise in section 7-504, stipulating that the transferee acquires those rights and interests which the transferor enjoyed. In short, this analysis suggests that in disputes between buyers and secured parties, Article 7 should govern. It also suggests the obvious: a buyer should not take subject to rights which accrue after delivery of the document.

On the other hand, application of Article 7 to disputes between two lenders would run counter to the thrust of section 9-312(1). This provision catalogs a number of exceptions to its priority rules for disputes between secured parties. It does not list any Article 7 provision. Application of Article 7 to lender situations also runs counter to the command of section 9-102 which stipulates that Article 9 applies to “any transaction (regardless of its form) which is intended to create a security interest in . . . goods.” In Boody, as opposed to the hypothetical, both parties presumably intended to take a security interest in the wool, rather than buy it. For that reason, and not because of compatibility between Article 9 and Article 7, Article 9 governed in Boody.

Thus, there is potential conflict between those two articles, and resolution of that conflict turns on the function of the receipt. If the receipt is a marketing device, Article 7 or some other buyer protection rule governs; if it is a financing device, Article 9 governs.

191. U.C.C. § 9-201 (emphasis added).
192. Significantly, however, § 9-312(1) does refer to a provision outside Article 9—§ 4-208. On the other hand, it provides that its rules only govern “when applicable.” U.C.C. § 9-312(1).
194. Indeed, the analysis should be helpful in settings unrelated to the 1972 amendments. It would be strange, for example, to say that a bank holding nonnegotiable receipts issued to a true owner and transferred to the bank as loan security under § 9-304(3) is the owner of the goods covered by those receipts. Strict application of § 7-504(1) to that situation, however, yields that conclusion. Article 9 gives the bank only a security interest and should control the ownership issue, if it ever arises. U.C.C. § 9-102(1)(a). Contra, NYTCO Services, Inc. v. Hurley’s Grain Elevator Co., 422 F. Supp. 114, 117 (W.D. Tenn. 1976). Of course, Article 7 would still apply to other rights the bank might enjoy as a nonqualified holder.
195. This analysis does not apply to disputes between a qualified holder and a secured party, however. Section 9-309 prohibits application of Article 9 priority rules to qualified holders whether they are buyers or lenders. See text accompanying notes 92-109 supra.
Conclusion

Proper analysis of a warehouse receipt holder’s rights turns on two independent inquiries: first, determining whether the holder is a qualified holder, and second, determining within which category of purchaser the holder falls.

In cases involving qualified holders, the Code chooses good faith purchase treatment. Such holders, whether they take as lenders or as buyers, take free of all claims, enjoy the full benefit of estoppel, and defeat prior secured parties whose interests arise at the time of or after issuance of the receipt. The chief limitation on the rights of the qualified holder lies in section 7-503, which recognizes a class of persons who defeat the qualified holder. That class consists of persons, true owners of the goods and secured parties, whose interests arise prior to issuance of the document. The qualified holder, however, can assert estoppel arguments against those persons with paramount rights and may defeat them.

Neither Article 2 nor Article 9 disturbs the framework of Article 7 for maintaining the rights of the qualified holder. In particular, section 9-309 does not expand qualified holder protection against prior secured parties. Section 9-309 applies only to security interests arising at the time of or after issuance of the receipt.

In cases involving holders who do not qualify for Article 7 good faith purchase treatment, application of estoppel principles must abide Article 2 and Article 9 inquiry. Section 7-504, a security of property rule, limits the rights of a nonqualified holder to those of the transferor. Such a holder, nonetheless, may be a buyer in ordinary course and may, therefore, benefit from the good faith purchase rules of Article 2 and Article 9. In the event the holder is not a buyer in ordinary course, the holder may at least be a buyer and benefit from the protection of section 9-301(1)(c). In short, the rights of the nonqualified holder depend on the function of the receipt. If the parties are using it to market the goods, the taker may benefit from the doctrine of good faith purchase. If, however, they are using it as a financing device, the doctrine is unavailable; the rights of the taker depend upon those of the transferor.

Estoppel is the chief ingredient of good-faith-purchase doctrine. It provides ample opportunity for commercial lawyers to advance the rule in favor of purchasers against those prior parties who guard their interests carelessly. While Articles 2 and 9 restrict application of these arguments for the benefit of buyers out of inventory, Article 7 extends
opportunities for estoppel to both buyers and lenders, so long as they are qualified holders.

In general, courts have not grasped the distinctions which govern the rights of qualified and nonqualified holders and have demonstrated marked reluctance to give full scope to the impact of estoppel. Those failures, which may stem from unawareness among commercial lawyers in general, frustrate the clear policy of the legislature as embodied in the Code.