Tulsa Law Review

Volume 17 | Number 4

Summer 1982

In Re Cox Cotton Co.: Is There a Right to Reclaim Bailed Property from the Estate of a Debtor under the Bankruptcy Code

Gerald Ediger

Follow this and additional works at: https://digitalcommons.law.utulsa.edu/tlr

 Part of the Law Commons

Recommended Citation
Gerald Ediger, *In Re Cox Cotton Co.: Is There a Right to Reclaim Bailed Property from the Estate of a Debtor under the Bankruptcy Code*, 17 Tulsa L. J. 728 (1982).

Available at: https://digitalcommons.law.utulsa.edu/tlr/vol17/iss4/4

This Casenote/Comment is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Tulsa Law Review by an authorized editor of TU Law Digital Commons. For more information, please contact megan-donald@utulsa.edu.

NOTES AND COMMENTS

IN RE COX COTTON CO.: IS THERE A RIGHT TO RECLAIM BAILED PROPERTY FROM THE ESTATE OF A DEBTOR UNDER THE BANKRUPTCY CODE?

I. INTRODUCTION

On February 16, 1981, Wayne Cryts[1] attracted national media attention[2] when he defied United States marshals and removed 31,000 bushels of soybeans from a Ristine, Missouri, grain elevator undergoing reorganization pursuant to the Bankruptcy Code (Code). Mr. Cryts' claim to the soybeans was based on the negotiable warehouse receipts he received when he delivered the soybeans to the grain warehouse prior to the reorganization proceedings. The federal marshals were present at the request of the bankruptcy trustee (Trustee). The Trustee claimed that the soybeans belonged to the debtor's grain warehouse and were part of the estate undergoing reorganization.

The competing claims which sparked this incident have resulted in the appointment of numerous investigatory task forces by both governmental bodies and private organizations.[3] The agricultural press,[4] re-

1. Mr. Cryts is a farmer from the Puxico, Missouri, area who is president of the Missouri Chapter of the American Agriculture Movement (AAM). *See* letter from Richard G. Steele, Missouri counsel for Trustee, to Ben F. Arnold, general counsel for Trustee (Feb. 2, 1981) and accompanying news articles (filed in No. J-80-154-B, Bankr. E.D. Ark., Feb. 5, 1981) [hereinafter referred to as Letter from R. Steele (Feb. 2, 1981)].

2. *E.g., U.S. Aides Warn Potential Buyers Of Beans Repossessed by Farmers*, N.Y. Times, Feb. 18, 1981, at 26, col. 1; *Farmers Take Impounded Soybeans, id.*, Feb. 17, 1981, at 14, col. 3. The story was apparently picked up by the national television networks. *See* Letter from R. Steele (Feb. 2, 1981) *supra* note 1.

3. Among the investigations begun in response to the Cryts incident were a USDA task force appointed by Secretary of Agriculture John Block, and congressional hearings in both houses of Congress before their respective agricultural committees. Several states have also begun similar investigations, including Oklahoma and Illinois. Private groups, such as the Oklahoma Feed and Grain Dealers' Association, have also commissioned studies.

4. *E.g., Let's stop these elevator losses*, Farm J., May 1981, at 48, col. 1; Whitsitt, *Speculation is factor in elevator failures*, Farmland News, Apr. 30, 1981, at 1, col. 4; *Elevator bankruptcies leave grain farmers with everything but the law on their side, id.*, Mar. 31, 1981, at 4, col. 2.

gional media,[5] and, to a lesser extent, nationally distributed periodicals,[6] have also continued to follow and analyze the proceedings in this case. The purpose of this Note is to examine the issues raised by this incident and dealt with by the Eighth Circuit Court of Appeals in *In re Cox Cotton Co.*,[7] as well as to explore proposed solutions to the problems of holders of warehouse receipts in future bankruptcy proceedings.

II. STATEMENT OF THE CASE

The Ristine confrontation exposed a myriad of related litigation.[8] Preliminary maneuvers had begun in August 1980 when the owners of several grain elevators in Missouri authorized the Missouri Department of Agriculture (Department) to assume control of all grain located in the owners' Missouri warehouses. This action was taken pursuant to Missouri laws which enabled the state to operate and/or liquidate insolvent grain elevators.[9] Accordingly, the Department filed receiver-

5. *E.g.*, *Missouri soybean farmer will ignore Arkansas court order*, The Tulsa [Okla.] Tribune, Oct. 7, 1981, at 7, col. 1; *Three Farmers Fined in Soybean Hassle*, The Enid [Okla.] Morning News, July 25, 1981, at A-2, col. 6; *Missouri Farmer Takes Soybeans*, Tulsa [Okla.] World, July 23, 1981, at 6, col. 3; *Trustee sells grain in defunct elevators*, The Tulsa [Okla.] Tribune, June 17, 1981, at 8, col. 5; *Ristine Elevator Raided On Weekend*, Perry [Okla.] Daily Journal, May 26, 1981, at 1, col. 7; *Judge Orders Grain Sold*, The Enid [Okla.] Morning News, May 21, 1981, at 4, col. 3; *Sell Grain in Bankrupt Warehouses Before It Rots, Trustee in Case Says*, [Little Rock] Arkansas Gazette, May 19, 1981, at 4A, col. 6.

6. *E.g.*, *Farmer Who Defied U.S. Cleared*, N.Y. Times, Mar. 21, 1981, at 4, col. 3.

7. Missouri v. United States Bankr. Ct. (*In re* Cox Cotton Co.), 647 F.2d 768 (8th Cir. 1981).

8. While related litigation continues, the time span under consideration in this Note encompasses the period of time from the assumption of control of the grain in the Missouri elevators by Missouri officials in August 1980, to the determination, on remand, by the United States Bankruptcy Court for the Eastern District of Arkansas (Bankruptcy Court) in late May 1981 that the soybeans should be sold.

9. Missouri Grain Warehouse Law, MO. REV. STAT. §§ 411.010-.765 (1978). Sections 411.519(1), (2), and (6) provide:

> 1. Whenever it appears to the satisfaction of the director that a licensed warehouseman does not have in his inventory sufficient grain to cover the outstanding receipts and scale tickets issued or assumed by him, or when the warehouseman refuses to submit his records or property to lawful examination, the director may give notice to the warehouseman to comply with any of the following requirements:
>
> (1) Cover the shortage by supplying the grain or evidence of ownership of the grain;
>
> (2) Give additional bond as required by the director;
>
> (3) Submit to such examination as the director may deem necessary;
>
> . . . .
>
> 2. Upon receipt of the director's verified petition setting forth the circumstances of the warehouseman's failure to comply with this chapter and further stating reasons why immediate possession by the director or his authorized agent is necessary for the protection of depositors, warehouse receipt holders or sureties, the court shall forthwith issue

ship petitions in the appropriate state circuit courts.[10] Only subsequent to this authorization did the owners (Debtors) file chapter 7 bankruptcy proceedings in the Bankruptcy Court for the Eastern District of Arkansas (Bankruptcy Court).[11] The following day, the Missouri courts appointed the director of the Department as receiver (Receiver) of the Debtors' warehouses, with instructions to take such actions as would "promote and protect the interests of the depositors of grain."[12] Three days later, Robert P. Lindsey was appointed interim trustee (Trustee), for the purpose of operating the Debtors' businesses until liquidation under chapter 7 could be accomplished.[13]

On September 3, the Receiver requested a hearing in Bankruptcy Court to determine the ownership of the grain.[14] The Bankruptcy Court granted the Receiver's request and scheduled a hearing for September 22. However, on the day of the hearing, the Debtors converted their chapter 7 liquidation proceedings to chapter 11 reorganization proceedings, and the Receiver served notice of dismissal of his request for a hearing to determine ownership.[15] In the interim between the Receiver's request for a hearing and the events of September 22, the Bankruptcy Court ordered the Receiver ousted of his possession of the Missouri warehouses.[16] Effective September 11, the Trustee was given

---

an order authorizing the director or his authorized agent to take immediate possession. . . . .

. . . .

6. If at any time, the director, whether or not he or his authorized agent has possession as authorized by this section, has evidence that a warehouseman is insolvent or is unable to satisfy the claims of all depositors, the director may petition the circuit court for the appointment of a receiver to operate or liquidate the business of the warehouseman in accordance with law.

Id.

10. On August 12, 1980, the director of the Missouri Department of Agriculture, John G. Runyan (Director) petitioned the circuit courts of New Madrid, Dunklin, Pemiscot, Ripley and Butler counties, Missouri, the locations of the Debtors' warehouses, for appointment as receiver of the warehouses.

11. Voluntary petitions for liquidation pursuant to chapter 7 were filed on behalf of Cox Cotton Company d/b/a James Grain and Cotton Company (No. J-80-154-B) and Don James, Robert James and G.E. James, a general partnership, d/b/a Frisbe Cotton Company; James Grain and Elevator (No. J-80-155-B). A voluntary petition for reorganization under chapter 11 of the Code was also filed by James-Agri Center, Inc., on the same day. James-Agri Center, Inc., is a debtor in possession under the Code.

12. *In re* Cox Cotton Co., 3 COLLIER BANKR. CAS. 2d (MB) 615, 619 (Bankr. E.D. Ark. 1980), *aff'd sub nom.* Missouri v. United States Bankr. Ct., 647 F.2d 768 (8th Cir. 1981), *cert. denied*, 50 U.S.L.W. 3531 (U.S. Jan. 11, 1982).

13. 3 COLLIER BANKR. CAS. 2d (MB) at 619.

14. *Id.* at 620.

15. *Id.* at 620-21.

16. *Id.* at 620. The order approved Trustee's Application for Grain Dealer and Warehouse Operator's Licenses, established Trustee's bond at $1,000,000, and directed the Trustee to "com-

possession of the warehouses in Missouri.[17] Furthermore, United States marshals were instructed to take "physical custody . . . of any equipment, personal property, or persons found to be blockading . . . the facilities . . . without the express written permission of the Trustee. . . ."[18] The bankruptcy judge considered these instructions necessary due to the immediate local outcry which arose against the transfer of possession of the facilities from the Receiver to the Trustee, and the perceived threat of a truck and tractor blockade of the premises.[19]

On September 23, the Trustee filed fifteen adversary proceedings against the State of Missouri and fourteen farmers to enable him to sell all grain located in both the Arkansas and Missouri warehouses, regardless of who held evidence of title.[20] Before the Trustee's motions in the adversary proceedings could be heard, however, the Receiver obtained an order in the Circuit Court of New Madrid County, Missouri, authorizing the Receiver to "take possession of and seize, by physical means, if required,"[21] the five warehouses in possession of the Trustee.[22] In response to this order, the Trustee informed counsel for

---

ply, to the extent possible," with the laws and regulations of Missouri dealing with the licensing of grain warehouses and grain dealers.

17. *Id.* The Bankruptcy Court ordered the Missouri officials to remove immediately: "[A]ny locks, chains, or other security devises [sic] at or upon any grain elevators or facilities owned so tht [sic] applicant may take possession of said warehouses and facilities, receive grain, and operate the businesses of the debtors consistent with the previous orders of this Court."

18. *Id.*

19. 647 F.2d at 771. In their petition to the Eighth Circuit, the Missouri officials recounted the following version of these events:

> Because of the intolerable situation created by their inability to get possession of their own property, the farmer-depositors either took possession of, or barricaded others from entering, the New Madrid (Ristine) grain warehouse of which the defendant Lindsey was and is trustee. The bankruptcy trustee responded with an application to the bankruptcy court asserting, with inflammatory charges, that these Missouri farmer-depositors were guilty of unlawful possession, criminal trespass and blockade. . . . United States Marshals appeared at the premises in force, and the farmers reluctantly went home.

Id. at 772 n.7.

20. 3 COLLIER BANKR. CAS. 2d (MB) at 621.

21. *Id.*

22. In its Petition For Immediate Possession, the Receiver alleged that the Trustee was in violation of the law in three areas. First, inasmuch as Missouri law required the Receiver to take possession of the warehouses and, upon demand, distribute the grain to the holders of warehouse receipts, the Trustee was interfering with the performance of the Receiver's duties. Second, since federal law and an order of the Bankruptcy Court required the Trustee to comply with state law, he was disregarding the state's definition of the scope of ownership interests in property, and he was disregarding the state's licensing and regulatory requirements. Third, to the extent that the grain was transferred or sold, the Trustee was disregarding both state and federal requirements.

The Trustee's application for a license to operate the warehouses had been rejected by the Department of Agriculture because the Trustee had stated in the application that he did not hold

the Receiver that contempt proceedings would be heard against him and other state officials who had joined in the state court action.[23]

Countering this threat, the Receiver sought a writ of prohibition from the Eighth Circuit Court of Appeals, which was denied.[24] However, the provisions of the Eighth Circuit's order denying the writ resulted in two important developments. First, while the order stayed the sale of any grain stored in Missouri, the stay did not apply to grain stored in Arkansas. Therefore, the Bankruptcy Court ordered the Arkansas grain sold on February 4, 1981.[25] This order brought a halt to ongoing settlement negotiations that were already jeopardized by the Trustees' inability to obtain the pre-petition market price for the grain.[26] Having obtained no relief through the judicial system, local farmers and the American Agricultural Movement organized efforts that resulted in the seizure and removal of 31,000 bushels of soybeans from the Ristine warehouse.[27] The second result of the Eighth Circuit's order denying a writ of prohibition was the Receiver's renewed attempt to seek judicial redress. The Eighth Circuit's order stated that its denial of the writ was without prejudice to the Receiver filing a petition for a writ of prohibition in the United States District Court for the Eastern District of Arkansas.[28] Accordingly, the Receiver petitioned for such a

---

any property for any other person. His claim was that all of the grain belonged to the Debtors' estate. This claim was first disclosed to Missouri officials after they had been forced to surrender possession of the warehouses.

The state court granted the Receiver's request for authorization to take immediate possession of the premises and to take the necessary steps to preserve the grain and the records of the warehouses. The state court also enjoined the Trustee from pursuing actions in other courts to escape compliance with the state court's exercise of jurisdiction over the subject matter. The Trustee was further enjoined from pursuing the adversary proceedings initiated against the holders of warehouse receipts and from moving the stored grain. Still further, the Trustee was enjoined from interfering with the actions of the Receiver in regaining possession of the grain and from acting as a grain dealer and warehouseman without a license from the state. *See* Petition for and Order Granting Immediate Possession and Injunction, State *ex rel.* Runyan v. Lindsey, No. CV-80-353 (Cir. Ct. of New Madrid County, Mo. 1980).

23. 3 COLLIER BANKR. CAS. 2d (MB) at 622.

24. *Id.*

25. *See* letter of Ben F. Arnold, counsel for Trustee, to Robert St. Vrain, clerk, United States Court of Appeals (Mar. 16, 1981) (filed in No. J-80-154-B, Bankr. E.D. Ark., Mar. 17, 1981).

26. *E.g., Six-month boom in soybeans is fizzling due to European tension, weak exports*, The Wall Street J., Dec. 5, 1980, at 46, col. 2.

27. The events of February 16, 1981, led to the arraignment of Wayne Cryts in the United States District Court for the Eastern District of Missouri on various felony and misdemeanor charges, including obstructing a marshal in the performance of his duties. A federal grand jury, however, refused to indict Mr. Cryts. *See Farmer Who Defied U.S. Cleared*, N.Y. Times, Mar. 21, 1981, at A4, col. 3; *U.S. Aides Warn Potential Buyers Of Beans Repossessed by Farmers, id.*, Feb. 18, 1981, at A26, col. 1; letter from Ben F. Arnold, counsel for Trustee, to Mr. Robert Kingsland, United States Attorney (Feb. 2, 1981) (filed in No. J-80-154-B, Bankr. E.D. Ark., Feb. 5, 1981).

28. The district court's opinion found that: (1) The legislative history of the Bankruptcy

writ, which the district court denied on December 2, 1980. Consequently, a second appeal was entered to the Eighth Circuit.

III. ANALYSIS BY THE EIGHTH CIRCUIT

The Eighth Circuit, in April 1981, affirmed the district court's denial of the Receiver's petition.[29] The Eighth Circuit reviewed three issues on appeal. First, the court weighed the Debtors' interest in the stored commodities to determine whether the jurisdiction of the Bankruptcy Court was established.[30] Second, the court considered whether the actions by the Missouri state officials fell within the governmental unit exception to the automatic stay of judicial proceedings which becomes effective upon the filing of the bankruptcy petition.[31] The third issue was whether the Trustee's failure to obtain a Missouri license to operate a grain warehouse deprived him of authority to sell or otherwise dispose of the stored commodities.[32]

The resolution of the first issue was dispositive of the farmers' right to reclaim the bailed property.[33] The Trustee advanced three the-

---

Reform Act of 1978 indicated an intent to grant broad jurisdiction to the Bankruptcy Court over the debtor and all his property, including property in dispute; (2) the actions of the State of Missouri were not an exercise of police or regulatory powers inasmuch as they had a direct bearing on the financial affairs of the debtor's estate and were in direct conflict with the jurisdiction of the Bankruptcy Court; (3) due to the request, later withdrawn, of the Receiver for a hearing before the Bankruptcy Court to determine the ownership of the grain, the State of Missouri had waived any claim of sovereign immunity to which it was entitled; (4) the supremacy clause contained in article 4 of the United States Constitution, when viewed in conjunction with the art. I, § 8, cl. 4, grant of power to Congress to establish uniform laws on the subject of bankruptcies, combine to vitiate any state action which would frustrate the power of the federal government; (5) the standards developed by the United States Supreme Court require that any party requesting a writ demonstrate that it is beyond dispute that the lower court is wrongfully assuming jurisdiction beyond its grant of authority. Such burden not being met the writ of prohibition was denied. 3 COLLIER BANKR. CAS. 2d (MB) at 623-26.

29. 647 F.2d at 778.

30. *Id.* at 774.

31. *Id.* at 776. The Eighth Circuit stated:

> [We] believe that the term "police or regulatory power" refers to the enforcement of state laws affecting health, welfare, morals, and safety, but not regulatory laws that directly conflict with the control of the *res* or property by the bankruptcy court . . . .
>
> We conclude that Missouri's grain laws, although regulatory in nature, primarily relate to the protection of the pecuniary interest in the debtors' property and not to matters of public safety and health.

Id. Accord In re King Memorial Hosp., Inc., 2 COLLIER BANKR. CAS. 2d (MB) 639 (Bankr. S.D. Fla. 1980).

32. 647 F.2d at 777.

33. The second issue dealt with the authority of the State of Missouri *qua* state, and was thus unrelated to the bailor's substantive rights. Of the third issue, the Eighth Circuit stated:

> We need not, however, decide this issue in the present proceeding. Inasmuch as we hold that the bankruptcy court possesses jurisdiction over the grain and the grain warehouses in Missouri, any complaint by Missouri regarding licensing may be presented to the

ories in support of the proposition that the Debtors' property interest was sufficient to establish jurisdiction of the Bankruptcy Court. First, the Trustee argued that jurisdiction was established by the fact that "the estate holds a lien against the grain for ongoing storage charges."[34] While the Eighth Circuit did not explicitly reject this argument, it did not recognize this as a basis for the Bankruptcy Court's jurisdiction. Instead, the court found jurisdiction based on the Debtors' possessory interest and ownership interest in the Missouri grain.[35]

On the question of possession, the court quoted the congressional committee report accompanying passage of the Code to the effect that "the debtor's interest in property . . . includes . . . a possessory interest."[36] Applying this to the record before it, the court stated:

> Since the debtors filed bankruptcy petitions prior to any state court order interfering with the debtors' right to possession, the debtors, rather than Missouri as receiver, had a possessory interest in the grain as of the commencement of the proceedings in bankruptcy.[37]

---

bankrupcy court . . . . [T]his particular challenge . . . provides no basis for issuing a writ of prohibition.

Id.

34. *Id.* at 774. The Code provides that the debtor's estate includes "[a]ny interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7) (Supp. III 1979). This would include ongoing storage charges. However, in *Cox Cotton* most of the storage charges were pre-paid through either September 30, 1980, or January 31, 1981. Petition for Immediate Possession and For Injunction at 8, State *ex rel.* Runyan v. Lindsey, No. CV-80-353 (Cir. Ct. of New Madrid County, Mo. 1980). Thus, as to such grain as was deposited with the storage charges pre-paid, ongoing storage charges, in and of themselves, could provide no basis for establishing jurisdiction over the property as of the "commencement of the case." 11 U.S.C. § 541(a) (Supp. III 1979). Admittedly, if jurisdiction is established on some other basis, ongoing storage charges accrue to the debtor's estate. Absent such other independent basis, however, jurisdiction could not be arbitrarily asserted and then justified by the fact that storage charges, and therefore a property interest, accrued after jurisdiction was wrongfully asserted. Thus, the Trustee's first theory under which jurisdiction attaches was circular and wholly without merit as to grain deposited with storage pre-paid. The Trustee attempted to establish his authority on the basis of post-petition storage charges that accrued only because his authority and the jurisdiction of the Bankruptcy Court were disputed. In other words, under this theory, any rights which the adverse claimants had were lost because such rights were asserted. *See generally* legislative statement following 11 U.S.C. § 541 (Supp. III 1979).

35. 647 F.2d at 774.

36. H.R. REP. NO. 595, 95th Cong., 1st Sess. 367, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6323; S. REP. NO. 989, 95th Cong., 2d Sess. 82, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5868 [hereinafter cited as S. REP. NO. 989].

37. 647 F.2d at 774 n.12. This statement is not an accurate chronology of the events. There was never any "state court order interfering with the debtor's right to possession" since the Debtors had authorized the state to assume possession and control of the grain prior to filing the initial bankruptcy petition. It was only after federal marshals had ousted the state of its possession of the property that a state court attempted to "interfere" with the *Trustee's* possession of the property. When these events are thus placed in their correct order, the court's premise of jurisdiction on the basis of the debtor's possession of the grain *as of the commencement of the case* falters, since the

Turning to the question of ownership, the court held that a "debtor's interest in property also includes 'title' to property, which is an interest, just as are [sic] a possessory interest, or leasehold interest, for example."[38] However, as to the estate's ownership in the grain,[39] the court found such interest to be tenuous on the basis of the record before it. In contrast to the warehouse receipts[40] offered by the Peti-

Debtors were not in possession at that time. Whether bailments in the possession of a state receiver would be required to be turned over to the estate under section 542 of the Code or constitute a voidable preference under section 547 was not discussed. For a discussion of whether property in the possession of a state receiver constituted possession by the debtor for purposes of establishing the jurisdiction of the bankruptcy court under the Bankruptcy Act, *compare* Gamble v. Daniel (*In re* Peters Trust Co.), 39 F.2d 447 (8th Cir.), *dismissed on appeal*, 281 U.S. 705 (1930), *cert. denied*, 282 U.S. 848 (1931) (possession of the property by a state liquidating agent does not deprive bankruptcy court of summary jurisdiction); *with* Marcell v. Engebretson, 74 F.2d 93 (8th Cir. 1934), *cert. denied*, 296 U.S. 579 (1935) (bankruptcy court lacks plenary jurisdiction to deprive state court trustees of possession of property).

38. 647 F.2d at 774 (quoting from S. REP. No. 989, *supra* note 36, at 82) (emphasis added).

39. The Trustee claimed that all the grain was property of the estate. 3 COLLIER BANKR. CAS. 2d (MB) at 626. However, the only basis on which the Trustee could lay claim to title to the grain is that the grain was delivered for sale at a future time. The Missouri statutes provide that a contract for sale includes a contract for a sale of goods at a future time. MO. REV. STAT. § 400.2-106(1) (1978). Thus, if the parties so intend, they can conclude a contract for sale without fixing the price. MO. REV. STAT. § 400.2-305 (1978). Subdivision 1(c) of section 400.2-305 provides that the price is reasonable if "fixed in terms of some agreed market or other standards as set or recorded by a third person or agency and it is not so set or recorded." Section 400.2-401(3)(b) provides that unless otherwise explicitly agreed, title passes at the time and place of contracting where the goods at that time are already identified and no documents are to be delivered. See *In re* Farmers Grain Exch., Inc., 1 BANKR. CT. DEC. (CRR) 1621, 1623 (Bankr. W.D. Wis. 1975).

Applying these sections to the evidence in *Cox Cotton*, it is plain that no sale occurred and that title to the soybeans did not pass to the Debtors at the time of delivery or upon the issuance of a warehouse receipt. The soybeans were held by the Trustee as bailee and belonged to the holders of negotiable warehouse receipts and the storers of grain on open storage. The grain was fungible and became part of the common mass in storage. Holders and storers became owners in common by virtue of section 400.7-207(2). That section also provides that where a mass of fungible goods is insufficient to meet the receipts validly issued against it, the persons owning the goods in common include all holders to whom overissued receipts have been duly negotiated. George v. Union Bank & Trust Co. (*In re* Farmers Grain Exch., Inc.), 10 COLLIER BANKR. CAS. (MB) 1 (Bankr. W.D. Wis. 1976).

40. Section 7-202(1) of the Missouri Uniform Commercial Code provides that "[a] warehouse receipt need not be in any particular form." MO. REV. STAT. § 400.7-202(1) (1978). Thus, in Missouri, variously labeled instruments have been construed to be warehouse receipts for purposes of the Uniform Commercial Code and prior statutory enactments. *See* Railey v. Leppert Roos Fur Co., 471 S.W.2d 270 (Mo. 1971) (cardboard stubs given in exchange for fur coats held susceptible of proof as warehouse receipts); National Match Co. v. Empire Storage & Ice Co., 227 Mo. App. 1115, 19 S.W.2d 565 (1929) (certificate promising redelivery of goods upon surrender of certificate held to be a negotiable warehouse receipt); Union Sav. Ass'n v. St. Louis Grain Elevator Co., 16 Mo. App. 560 (1885) (shipping tickets held to evidence sale and not a bailment).

The Bankruptcy Court seemed to attach some significance to the fact that during the short, hectic period during which grain is harvested, weight tickets, not warehouse receipts, were issued. However, it is a universally common practice to supply weight tickets for the grain upon delivery. Warehouse receipts are later obtained primarily for the purpose of obtaining loans, particularly government loans issued through the Commodity Credit Corporation (CCC). Also common is the practice of leasing property for a portion of the crop, resulting in the issuance of warehouse re-

tioners as evidence of their ownership rights in the property, the court found that "[t]he trustee . . . has presented no documents of title to substantiate his claim of ownership."[41] The court characterized that portion of the property to which the Trustee might plausibly assert title as being "minute."[42]

In conclusion, the court found that the Bankruptcy Court might authorize the sale of the property, but only upon the establishment of five alternative prerequisites,[43] none of which were held to be established on the basis of the record.[44] Further, the Eighth Circuit instructed the Bankruptcy Court to "particularly examine its authority to order the sale if title documents indicate that the estate possesses no substantial ownership rights to the grain. . . ."[45] The court stated that the Code makes it clear that when "persons other than the debtor have an interest in the property, adequate protection must be taken 'as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.' "[46]

---

ceipts to substantiate the landlord's interest. However, given the latitude with which Missouri courts have construed various instruments as warehouse receipts, at least as non-negotiable receipts, the Bankruptcy Court's concern that a minority of farmer-claimants held only weight tickets seems misplaced.

The present system of commingling parcels and lots of grain and certifying ownership through the issuance of negotiable warehouse receipts dates to the middle of the nineteenth century. *See* Munn v. Illinois, 94 U.S. 113, 131 (1876) (state regulation of grain warehouses upheld). *See also D. Morgan, Merchants of Grain* (1979) (receipt system adopted by N.Y. Produce Exchange in 1874) at 100.

41. 647 F.2d at 774.

42. *Id.*

43. *Id.* at 778. The five alternative prerequisites are set out in 11 U.S.C. § 363(f) (Supp. III 1979):

> The trustee may sell property under subsection (b) [other than in the ordinary course of business] or (c) [in the ordinary course of business] of this subsection free and clear of any interest in such property of an entity other than the estate, only if—
>
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) such entity consents;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of such interest;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Id.

44. 647 F.2d at 778.

45. *Id.*

46. *Id.* (quoting from 11 U.S.C. § 361(3)). The Eighth Circuit's final suggestions were for the Bankruptcy Court to consider 1) dismissal of contempt proceedings against petitioners, 2) the advice of the Acting Director of Agriculture for the State of Missouri, and 3) the possible appointment of a special master to expedite the determination of ownership of the Missouri grain.

IV. DISCUSSION

A. *Are Bailed Goods Part of the Debtor's Estate?*

In evaluating a bailor's right to reclaim bailed goods from the debtor's estate, it must initially be determined whether such goods are property of the debtor's estate under section 541 of the Code.[47] If they are not, a bankruptcy court has no jurisdiction over them, and a bailor would have a right to reclaim them subject to the terms of the bailment and applicable nonbankruptcy law. Under the Bankruptcy Act (Act),[48] it was well settled that bailment terms and state laws controlled, and that a right of reclamation existed unless such terms and statutes provided otherwise. For example, in the case of *In re John Kingsley, Inc.*,[49] the court stated:

> The only question, as I see it, upon which the rights of the parties turn, is whether under the circumstances disclosed in the certificate, concerning which there seems to be no dispute, the bankrupt can be said to have become the ostensible owner, or, in other words, whether [the claimant] was estopped from denying that the bankrupt had complete title to the merchandise. . . .
>
> In my opinion, the doctrine of ostensible ownership cannot be extended to reach this case. . . .
>
> The mere possession alone is not sufficient to preclude the owner from asserting his title. . . .
>
> . . . .
>
> . . . I have no doubt that the transaction here involved amounted to a bailment and that the property was in the bankrupt's possession as bailee or agent and, according to well-settled authority, under such circumstances the bailor or principal may recover the property.[50]

In *Hatter v. United States* (*In re Bowling Green Milling Co.*)[51] on facts remarkably similar to those of *Cox Cotton*, the Sixth Circuit Court of Appeals held:

> No substantial evidence was introduced to show that the transaction between the bankrupt and the holders of the white

47. 11 U.S.C. § 541 (Supp. III 1979).

48. Act of July 1, 1898, ch. 541, 30 Stat. 544 (amended 1938), *repealed by* the Bankruptcy Reform Act of 1978, Pub. L. No. 598, 92 Stat. 2549.

49. 8 F. Supp. 303 (D. Mass.), *aff'd sub nom.* Nathanson v. Worchester Bank & Trust Co., 73 F.2d 889 (1st Cir. 1934).

50. 8 F. Supp. at 304.

51. 132 F.2d 279 (6th Cir. 1942).

> [warehouse] receipts constituted a sale. The wheat was delivered, but no money passed at the time of delivery and no agreement was made by the bankrupt to pay any specific amount at any time in the future. . . . The provision for storage for such an extended period smacks not of sale, but of bailment. . . .
>
> . . . .
>
> The fact that numerous holders of the white receipts gave up these receipts for blue receipts [to obtain government loans] . . . does not tend to establish that there was a sale. . . . In fact the entire underlying theory of these government loans . . . was that the farmers retained title to the wheat after delivery to the warehouseman.
>
> . . . Inasmuch as all holders are bailors, the entire mass of the wheat is owned in common, title never passed to the bankrupt, and the wheat . . . is to be distributed to the claimants, including the [Commodity] Credit Corporation, on a pro rata basis.[52]

The greatest difficulty encountered in these cases was whether, under state law prior to the adoption of the Uniform Commercial Code (U.C.C.), a legitimate bailment was created or whether the agreement was a disguised sale or secured transaction.[53] These problems were eliminated by the adoption of the U.C.C.[54] However, the Code

---

52. *Id.* at 284. However, in dictum, the Sixth Circuit equated the powers of a bankruptcy court with the broad common law powers of any other court of equity, and stated: "We do not decide that the only possible disposition of this case requires the wheat to be distributed in kind, for we think the bankruptcy court has ample authority to order a sale and distribution of the proceeds if it deems such procedure the most fair and equitable." *Id.* This was not, however, the majority view under the Act. *See* Fernow v. Liberty Royalties Corp., 146 F.2d 396, 397 (10th Cir. 1944) (bankruptcy court only authorized to sell property of bankrupt, not property belonging to third parties); New Albany Trust Co. v. Vogt (*In re* Yost & Cook), 70 F.2d 614, 616 (6th Cir. 1934) (bankrupt had never owned the real property that was subject matter of dispute, and therefore it was not subject to sale by bankruptcy court); *In re* Gorwood, 138 F. 844, 845 (M.D. Pa. 1905) (trustee only authorized to sell bankrupt's rights in property). For a discussion of the statutory requirements that must be met prior to such a sale under the Code, see *infra* text accompanying notes 83-115.

53. *E.g.*, Sandack v. Tamme (*In re* Hatfield), 182 F.2d 759 (10th Cir. 1950) (consignment was a bailment not a sale); Nathanson v. Worchester Bank & Trust Co., 73 F.2d 889 (1st Cir. 1934) (consignment of jewelry was a bailment); *In re* Klein, 3 F.2d 375 (2d Cir. 1924) (consignment creates a bailment).

54. U.C.C. § 2-401 (1978) states: "Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title." The Official Comment to this section states: "This Article deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not 'title' to the goods has passed."

U.C.C. § 9-202 (1978) provides: "Each provision of this Article with regard to rights, obliga-

presents the new problem of whether even a legitimate bailment becomes property of the debtor's estate.

Before the Eighth Circuit, the Trustee advanced the proposition that due to the Code's broadly inclusive definitions of the debtor's "property"[55] and the debtor's "estate,"[56] and the Code's automatic stay provisions preventing actions to obtain property "of the estate" or "from the estate,"[57] the pre-Code right to reclaim bailed goods had been abolished. This interpretation has been adopted by at least one recent commentary on the Code. The authors of *Collier on Bankruptcy (Collier)* state:

> [I]t became well settled under the Bankruptcy Act that absent statutory enactment to the contrary, if property was in a debtor's hands as bailee or agent, the trustee held it as such, and the bailor or principal could recover the property or its proceeds. Under the Code, section 362 will automatically stay the bailor or principal from divesting the debtor of possession, and the estate will include the debtor's rights under the bailment, agency, or consignment agreement.[58]

In contrast to this interpretation, the authors of *Bankruptcy Service, Lawyers' Edition (Bankruptcy Service)* adopt the position taken by the Receiver before the Eighth Circuit, upholding the right to reclaim property from the debtor's estate that is in the debtor's possession pursuant to a bailment agreement at the time the petition is filed.[59] The authors state: "[B]ailed goods . . . are required to be returned to the proper party . . . as required by cases decided under former law."[60]

Any remaining doubt that the two commentaries adopt conflicting opinions on this point is dispelled by noting the authority each cited. *Collier* cites[61] *In re John Kingsley, Inc.*,[62] *inter alia*,[63] as an example of

---

tions and remedies applies whether title to collateral is in the secured party or in the debtor." The Official Comment to this section states:

> The rights and duties of the parties to a security transaction and of third parties are stated in this Article without reference to the location of "title" to the collateral. Thus the incidents of a security interest which secures the purchase price of goods are the same under this Article whether the secured party appears to have retained title or the debtor appears to have obtained title and then conveyed it or a lien to the secured party.

55. 11 U.S.C. § 541 (Supp. III 1979).
56. *Id.*
57. *Id.* § 363.
58. 4 COLLIER ON BANKRUPTCY ¶ 541.08, at 541-39 (15th ed. 1981) (citations omitted).
59. 1 BANKRUPTCY SERVICE—LAWYERS EDITION ¶ 4:22, at 43 (1979).
60. *Id.*
61. 4 COLLIER ON BANKRUPTCY ¶ 541.08, at 541-38 (15th ed. 1981).
62. 8 F. Supp. 303 (D. Mass.), *aff'd sub nom.* Nathanson v. Worchester Bank & Trust Co., 73 F.2d 889 (1st Cir. 1934).

the right of reclamation that existed under the Act, but which has been abolished under the Code; *Bankruptcy Service* cites the same case as an example of a practice that continues under the Code.[64]

The Eighth Circuit, attempting to resolve this same conflict, held that the Code's legislative history reflected an intent to so broadly define "property" as to require the inclusion of bailed goods within the definition of property to be included in the Debtors' estate.[65] Significantly, however, the court did not make reference to the congressional report's example of property that is not to be included in a debtor's estate under section 541.[66] The congressional report states:

> Situations occasionally arise where property ostensibly belonging to the debtor will actually not be property of the debtor, but will be held in trust for another. For example, if the debtor has incurred medical bills that were covered by insurance, and the insurance company had sent the payment of the bills to the debtor before the debtor had paid the bill for which the payment was reimbursement, the payment would actually be held in constructive trust for the person to whom the bill was owed.[67]

While the legal relationships between the parties in the instant case differ from those in the above cited example, the fact patterns are analogous, and the rule to be derived is equally applicable to bailment relationships. Central both to the example and to bailments is the debtor's present possession of property to which he holds no further property interest. Implicit in this illustration is the requirement that the bankruptcy court treat property in which the debtor holds only a possessory interest in a manner distinct from property subject to the claims of creditors, since such property is to be held in constructive trust. Hence, such property as only "ostensibly" belongs to the debtor must be excluded and is arguably subject to reclamation by the bailor.

B. *Even If The Bailed Goods Are Part Of The Debtor's Estate, Does A Right Of Reclamation Exist?*

While the Eighth Circuit rejected the Receiver's request for a writ

63. *In re* Hedgeside Distillery Corp., 123 F. Supp. 933 (N.D. Cal. 1952), *aff'd sub nom.* Anglo Bank v. Schenley Indus. Inc., 215 F.2d 651 (9th Cir. 1954); *see also* Kaplan v. Clark (*In re* Klein), 3 F.2d 375 (2d Cir. 1924).

64. 1 BANKRUPTCY SERVICE—LAWYERS EDITION ¶ 4: 22, at 43 (1979).

65. 647 F.2d at 774.

66. S. REP. No. 989, *supra* note 36, at 82.

67. *Id.*

of prohibition to prevent the Bankrupcty Court's exercise of jurisdiction over the bailed goods, a careful reading of the opinion indicates that it did not wholly reject the Receiver's argument that the bailors retained the right to reclaim the bailed property. The court held that the Bankruptcy Court possessed only "preliminary jurisdiction"[68] over the property, and that the grain was property of the estate for jurisdictional purposes only, pending determination of actual ownership.

Under such circumstances, section 361 places a burden on the trustee to take measures to provide "adequate protection"[69] to an entity claiming an interest in the property and to afford such relief "as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."[70] While the *method* of providing an "indubitable equivalent"[71] is discretionary and is left to case-by-case development,[72] the trustee's *duty* to adequately protect the claim-

68. 647 F.2d at 774.

69. The Commission on the Bankruptcy Laws of the United States, in its proposed Bankruptcy Act of 1973, suggested the concept of "adequate protection" in section 7-203(b) which was in part the precursor of section 363 of the Code. *See* H.R. Doc. No. 137, Part II, 93d Cong., 1st Sess. 236 (1973). The term "adequate protection" is, however, considerably older than the commission report, and was the basis for the treatment of objecting classes of creditors under chapters X and XII where a plan was to be confirmed over the dissents of such classes. Sections 216(7) of chapter X and 651(11) of chapter XII both provided that this might be done by providing such classes with "adequate protection for the realization by them of the value of their claims against the property dealt with by the plan . . . ." Similar language appeared in subsection (b)(5) of section 77B, the predecessor to chapter X.

70. 11 U.S.C. § 363(3) (Supp. III 1979).

71. This term originates from the leading case construing the "adequate protection" provision of section 77B of the Bankruptcy Act, *In re* Murel Holding Corp., 75 F.2d 941 (2d Cir. 1935). The opinion, written by Circuit Judge Learned Hand, states:

> The argument and the briefs have taken a wide range, being for the most part directed to the powers of the court. We do not find it necessary to discuss the points raised, because it seems to us that though for argument we assume that the judge had power to grant the stay, there was not enough before him to justify one . . . . In construing so vague a grant [as the power to provide adequate protection], we are to remember not only the underlying purposes of the section, but the constitutional limitations to which it must conform. It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now . . . . We see no reason to suppose that the statute was intended to deprive [the creditor of the immediate return of his money or property] in the interest of junior holders, *unless by a substitute of the most indubitable equivalence*.

Id. at 942 (emphasis added). Thus, a narrow construction of this "vague grant" was adopted by subsequent case law. *See* National City Bank of N.Y. v. O'Connell, 155 F.2d 329 (2d Cir. 1946); Kyser v. McAdam, 117 F.2d 232 (2d Cir. 1941).

72. The one exception to the flexibility allowed by this action is the prohibition against granting administrative priorities to afford adequate protection as was suggested in *In re* Yale Express System, Inc., 384 F.2d 990 (2d Cir. 1967). The Senate report characterized such an approach as "too uncertain to be meaningful." S. REP. No. 989, *supra* note 36, at 54. For a discussion of the appropriateness of allowing case-by-case development rather than providing clear rules on the control of collateral, *compare* Webster, *Collateral Control Decisions in Chapter Cases, Clear Rules v. Judicial Discretion*, 51 AM. BANKR. L.J. 197 (1977) *with* Murphy, *Use of Collateral in Business*

ant's interest is mandatory.[73] Thus, if a trustee is unable to provide adequate protection, the bankruptcy court is under an obligation to lift the stay of judicial proceedings and allow foreclosure.[74]

The issue arises whether the titleholders to the grain in *Cox Cotton* were offered adequate protection of their ownership rights in the grain.[75] To resolve this issue, a value must be placed on the offered equivalent. Determining the appropriate valuation standards has proved troublesome. Prior to the adoption of the Code, the Commission on the Bankruptcy Laws of the United States suggested that "a benchmark in determining adequate protection is the liquidation value of the collateral at the date of the petition."[76] However, Congress rejected this approach. Instead, the congressional reports indicate that the value placed on the offered equivalent should fall within a range, with the liquidation value at the date of the petition providing the lower end of the range.[77] The upper limit is to be represented, for ex-

---

Rehabilitations: A Suggested Redrafting of Section 7-203 of the Bankruptcy Reform Act, 63 CALIF. L. REV. 1483 (1975).

73. 2 COLLIER ON BANKRUPTCY ¶ 363.06, at 363-26 (15th ed. 1981), wherein it states:

> If adequate protection cannot be offered then the proposed use, sale, or lease must be conditioned to provide adequate protection, and if it cannot be so conditioned must be prohibited. It is safe to say that this position has been taken as much for policy reasons as for any possible constitutional reasons. Cases under the Act which in mistaken reliance upon language in *Continental Illinois Nat'l Bank and Trust Co. v. Chicago, Rock Island & Pacific Railway Co.* suggested that relief from bankruptcy court stays was simply an issue addressed to the court's discretion rather than its power are now limited.

Id. (footnotes omitted). *See* Continental Illinois Nat'l Bank and Trust Co. v. Chicago, Rock Island & Pac. Ry. Co., 294 U.S. 648, 675-78 (1935); *see also* Wright v. Union Central Life Ins. Co., 311 U.S. 273 (1940) (impairment of secured creditors' rights not to be permitted on constitutional grounds); H.R. REP. NO. 595, 95th Cong., 1st Sess. 339, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6295 (impairment of rights of secured creditors not to be permitted on policy grounds).

74. Section 362(d) states that "the court *shall grant relief* from the stay . . . for cause, including the lack of adequate protection of an interest in property of such party in interest . . . ." 11 U.S.C. § 362(d)(1) (Supp. III 1979) (emphasis added).

75. The Eighth Circuit specifically instructed the Bankruptcy Court to consider subsection 3 of 11 U.S.C. § 361. 647 F.2d at 778. While the drafting of this section indicates a primary concern with the problems of secured creditors, these are merely examples of adequate protection given to illustrate possible approaches to commonly recurring problems and "other parties such as consignors, lessors, and co-owners are also entitled to demand adequate protection of their interest in the debtor's property." 3 COLLIER ON BANKRUPTCY ¶361.01, at 361-12 (15th ed. 1981).

76. H.R. DOC. NO. 137, Part II, 93d Cong., 1st Sess. 237 (1973).

77. The Senate report states:

> Neither is it expected that the courts will construe the term value to mean, in every case, forced sale liquidation value or full going concern value. There is a wide latitude between those two extremes although forced sale liquidation value will be a minimum.
>
> In any particular case, especially a reorganization case, the determination of which entity should be entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations arising from the facts of the case.

S. REP. NO. 989, *supra* note 36, at 54.

ample, by the value placed on a business as a full going concern.[78] This approach prevents those with interests in the property from being forced to accept fire sale prices as the equivalent of adequate protection.[79]

In the *Cox Cotton* situation, "full going concern" does not easily translate to a standard that can be used to determine the upper end of the valuation range of the soybeans. Instead, a higher value should be placed on the right to speculate on the soybeans, than on the more limited right to receive the proceeds from a sale in which the date and price are arbitrarily determined by third parties. For present purposes, however, this standard need not be determined since it is clear that the grain depositors were not even offered the equivalent of the lower valuation standard. Due to the decline in soybean prices,[80] the Trustee was unable to offer even the liquidation value of the soybeans at the date of the petition and did not offer any additional protection to compensate for the deficiency. Thus, it is clear that the protection offered was not adequate. Under such circumstances, it must be concluded that the Bankruptcy Court violated its duty to assure such protection and should have lifted the automatic stay[81] of judicial proceedings against the property of the estate as to the stored grain.[82]

---

78. *Id.*

79. An argument can be made that a low valuation works both an advantage and a disadvantage:

> If, at the outset of the case, the creditor asserts a high collateral valuation, a risk is run that this high valuation will be the basis of the court's determination that the creditor is adequately secured and hence not in need of additional protection. Conversely, an assertion of low collateral value may not be believed, and, if it is, can lead to unexpected results. A low collateral value can also make matters much easier for the debtor at the time of confirmation. Further, low collateral values may make the providing of adequate protection relatively easy or even lead to the determination that a valueless junior interest need not be protected at all. . . . [I]t is in the creditor's interest to allege the true value of the collateral to the extent such a value is ascertainable.

2 COLLIER ON BANKRUPTCY ¶ 361.02, at 361-14 (15th ed. 1981) (footnotes omitted).

80. *E.g., Six-month boom in soybeans is fizzling due to European tension, weak exports*, The Wall Street J., Dec. 5, 1980, at 46, col. 2.

81. 11 U.S.C. § 362 (Supp. III 1979).

82. If it is hypothesized that the proceedings had not been converted from chapter 7 to chapter 11, it is not even necessary to resort to this rather inexact formula due to the provisions of section 725. This section provides:

> After the commencement of a case under this chapter [7], but before final distribution under section 726 of this title [11], the trustee, after notice and a hearing, shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title.

11 U.S.C. § 725 (Supp. III 1979). Explaining this rather obscure language, the Senate report states: "The purpose of the section is to give the court the appropriate authority to ensure that collateral or its proceeds is returned to the proper secured creditor, *that consigned or bailed goods*

C. *If Adequate Protection Is Otherwise Provided, Does The Code Nevertheless Preclude Sale Of The Bailed Goods?*

As already noted, the proceeds from the sale of the grain did not—without more—provide adequate protection to the holders of warehouse receipts. However, if it was shown that protection was to be afforded in addition to the sale proceeds, the remaining issue is whether the Trustee met the statutory requirements which condition such sales. The standards which must be met before there can be a sale free and clear of liens are set forth in section 363(f) of the Code.[83] Notably, the language of this section is in the disjunctive; a sale free of the interest concerned can occur if any one of the conditions of section 363(f) have been met.

Subsection 1 provides that a trustee may sell free and clear of any interest only if "applicable nonbankruptcy law would permit a sale of such property free of the interest."[84] Under the circumstances of this case, the applicable law is Article 7 of the U.C.C., as adopted by Missouri.[85] Section 7-403 sets forth the general obligation of the warehouseman to deliver the goods to the holder of the document of title.[86] In addition, section 7-207 states:

> (1) Unless the warehouse receipt otherwise provides, a warehouseman must keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods except that different lots of fungible goods may be commingled.
>
> (2) Fungible goods so commingled are owned in common by the persons entitled thereto and *the warehouseman is severally liable to each owner for that owner's share*. Where because of overissue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom

---

are returned to the consignor or the bailor, and so on." S. REP. No. 989, *supra* note 36, at 96 (emphasis added).

Of significance for the instant hypothetical is that the phrase "or its proceeds" modifies "collateral" and not "bailed goods." Thus, if all other facts remained the same except that *In re* Cox Cotton had never been converted to a chapter 11 proceeding, the grain depositors could have reclaimed their soybeans. A limiting factor, however, is the reference in section 725 to disposition under other sections of the Code. For example, if the property has been disposed of by abandonment under section 554, by sale under section 363, or by foreclosure by a secured creditor by lifting the stay under section 362, then section 725 will not apply.

83. *See supra* note 43.

84. 11 U.S.C. § 363(f)(1) (Supp. III 1979).

85. MO. REV. STAT. §§ 400.7-101 to -603 (1978).

86. *Id.* § 400.7-403.

overissued receipts have been duly negotiated.[87]

Derived from the Uniform Warehouse Receipts Act,[88] this section's provision establishing the warehouseman's liability to "each owner for that owner's share"[89] has been construed to preclude *any* sale of the bailed goods. Where, due to overissue, the goods are "insufficient to meet all the receipts which the warehouseman has issued" against the mass, the courts of Missouri[90] and other jurisdictions[91] have required the pro rata distribution of the goods. Given such requirements, it is difficult to imagine circumstances under which a trustee in bankruptcy could conceivably sell the goods free and clear of liens under Missouri law.

Subsection 2 provides that a trustee may conduct a sale free and clear of "any interest in such property of an entity other than the estate, only if . . . such entity consents."[92] Given the general tenor of the relations between the litigants in this case, consent is an unlikely basis for authority to determine ownership, sell the grain, and distribute the proceeds. Nevertheless, the district court opinion,[93] issued prior to the second appeal to the Eighth Circuit, held that consent was one basis for establishing the authority of the Bankruptcy Court to determine ownership of the property. Consent was implied from the Receiver's having filed a claim against the Debtors' estate, and having filed a request, subsequently withdrawn, for a hearing to determine ownership.[94] Inasmuch as the Receiver was in possession[95] of the property when the petition was filed, the Bankruptcy Court had neither title nor possession, presenting a problem which "has historically been . . . very thorny . . . for bankruptcy practitioners, the courts and Congress."[96] However, in light of the amount of litigation that has been precipitated by

87. *Id.* § 400.7-207 (emphasis added).

88. UNIFORM WAREHOUSE RECEIPTS ACT §§ 22-24, 3A U.L.A. 548 (1981) (superceded by U.C.C. § 7-207).

89. *Id.*

90. Summers v. People's Elevator Co., 136 S.W.2d 81 (Mo. Ct. App. 1940).

91. *E.g.*, United States v. Luther (*In re* Garden Grain & Seed Co., Inc.), 225 F.2d 499, 504-05 (10th Cir. 1954); Hatter v. United States (*In re* Bowling Green Milling Co.), 132 F.2d 279, 284 (6th Cir. 1942); *In re* Farmers Grain Exch., Inc., 1 BANKR. CT. DEC. 1621, 1622 (Bankr. W.D. Wisc. 1975); State *ex rel.* Crawford v. Centerville Grain Co., Inc., 5 Kan. App. 2d 451, 453, 618 P.2d 1206, 1210 (1980); Goodman v. Northcutt, 14 Or. 529, —, 13 P. 485, 488 (1887); Dole v. Olmstead, 36 Ill. 150, 155, 85 Am. Dec. 397, — (1864).

92. 11 U.S.C. § 363(f)(2) (Supp. III. 1979).

93. 3 COLLIER BANKR. CAS. 2d (MB) 615 (Bankr. E.D. Ark. 1980).

94. See *supra* text accompanying notes 14-16.

95. See *supra* note 37.

96. *In re* Los Angeles Trust Deed & Mortgage Exch., 464 F.2d 1136, 1140 (9th Cir. 1972), *cert. denied*, 409 U.S. 1064 (1973).

this question,[97] the district court too easily found implied consent.[98] The withdrawal of the request for determination of ownership should have been more carefully analyzed in the context of the tumultuous events that transpired after the request was originally entered.[99] While the district court concluded that the state failed to enter a timely objection to jurisdiction and voluntarily relinquished possession of the property, federal marshals were needed to take possession of the property. The district court glossed over this key fact. At the very least the events which transpired indicated an implied objection to jurisdiction rather than implied consent. The fact that the request was withdrawn within twenty days[100] also suggests that if the withdrawal constitutes an objection to jurisdiction, it was timely.[101] Furthermore, even if consent to an adjudication of ownership can be implied, it does not follow that consent to the sale of the property can also be implied.

Subsection 3 permits a trustee to sell the property free and clear of any interest in such property if "such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of such interest."[102] Even if the warehouse receipts should be construed to constitute liens against the grain, it is clear that the price received from the proposed sale would render this subsection inapplicable.[103] Closely related is subsection 5, which allows a free and clear sale if the

97. See cases cited in *In re* Balogh & Co., 432 F.2d 1343, 1347 (D.C. Cir. 1970).

98. For a discussion and annotation of the evolution of the consent doctrine under the Bankruptcy Act, see Inter-state Nat'l Bank v. Luther (*In re* Garden Grain & Seed Co., Inc.), 221 F.2d 382, 386-89 (10th Cir. 1955).

99. See *supra* text accompanying notes 20-28.

100. 3 COLLIER BANKR. CAS. 2d (MB) at 620.

101. Bankruptcy Rule 712(b) provides that rules 12(b)-(h) of the Federal Rules of Civil Procedure generally apply to objections to subject matter jurisdiction. Federal rule 12(h)(1)(B) states that an objection to jurisdiction is waived "if it is neither made by motion under this rule nor included in a responsive pleading or an amendment thereof permitted by rule 15(a) to be made as a matter of course." Rule 15(a) provides that a "party may amend his pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar, he may so amend it at any time *within 20 days after it is served.*" FED. R. CIV. P. 15(a) (emphasis added). In *Cox Cotton*, the Receiver met the above time limit for filing an objection by withdrawing his Request for Determination of Ownership. Thus, his withdrawal should act as an objection to the jurisdiction of the Bankruptcy Court, at least by implication.

An analogous situation is presented by Bankruptcy Rule 305 which provides that a "creditor may withdraw a claim as of right by filing a notice of withdrawal" unless an objection to the claim has been filed. Once a claim is withdrawn, the bankruptcy court no longer has jurisdiction over it. Similarly, by withdrawing his Request for Determination of Ownership, the Receiver withdrew this issue from the jurisdiction of the Bankruptcy Court. Accordingly, in both situations, the net effect of the Receiver's actions was to place him in the same status he held prior to filing his Request for Determination of Ownership.

102. 11 U.S.C. § 363(f)(3) (Supp. III 1979).

103. See *supra* note 26 and accompanying text.

entity claiming an interest "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."[104] This subsection must be interpreted in light of the "adequate protection" requirements of sections 361, 362(d)(1), and 363(e), because, to the extent that the "money satisfaction" to be derived from the sale fails to comport with "adequate protection," the entity claiming the interest cannot be compelled to accept such sum as satisfaction of its interest.[105] Thus, this section is also inapplicable.

Subsection 4 permits a free and clear sale if there exists a "bona fide dispute"[106] over the property. On remand, the Bankruptcy Court specifically held that this subsection provided the basis for ordering the sale of the grain.[107] The dispute to which the Bankruptcy Code referred was the interest claimed by First Tennessee Bank, N.A.-Memphis (Bank) in the grain both as a holder of negotiable warehouse receipts issued as collateral for a $500,000 loan, and as a perfected secured party under Article 9 of the U.C.C.[108] The Eighth Circuit only cited three cases in reference to this claim.[109] Significantly, two of the three cases enunciate a bailor's right to reclaim property.[110] Even more

104. 11 U.S.C. § 363(f)(5) (Supp. III 1979).

105. See *supra* text accompanying notes 69-82.

106. 11 U.S.C. § 363(f)(4) (Supp. III 1979).

107. Lindsey v. First Tennessee Bank, No. J-80-154-B, Adv. Proc. No. 800414 (Bankr. E.D. Ark. May 27, 1981).

108. The relationship between Articles 7 and 9 in a bankruptcy proceeding is discussed in *In re* Fairfield Elevator Co., Inc., 14 U.C.C. REP. SERV. (CALLAGHAN) 96 (Bankr. S.D. Iowa 1973). There the court stated:

> There is nothing in Article 9 that dilutes the rights of such a holder under Article 7.
>
> When the agreement was made between the producer and the Government to sell the grain to the elevator the warehouse receipts gave up the role of collateral [for the government loan] and assumed their primary role as documents of title and symbols of the grain itself. The Government was the seller of its property interest under its agreement with the producer and had bare title. The producer was also the seller of its property interest under the agreement with the Government. . . .
>
> . . . .
>
> . . . Whether the Government continued to have a security interest in the grain after it surrendered the possession of the warehouse receipts is governed by Article 9 of the UCC. The only way the Government could retain a perfected security interest in the warehouse receipts after delivery would have been by properly filing its security agreement or a financing statement.

Id. at 105, 108-09.

109. 647 F.2d at 775. *See* Clemens v. Clemens (*In re* Clemens), 472 F.2d 939 (6th Cir. 1972); Kutcher v. Liskey (*In re* Universal Medical Serv.), 460 F.2d 524 (3d Cir. 1972); *In re* Farmers Grain Exch., Inc., 1 BANKR. CT. DEC. (CRR) 1621 (Bankr. W.D. Wis. 1975), *subsequent proceedings* George v. Union Bank & Trust Co. (*In re* Farmers Grain Exch., Inc.), 10 COLLIER BANKR. CAS. (MB) 1 (Bankr. W.D. Wis. 1976).

110. Typical of the language used by these cases is the statement "[w]here proper proof is presented that property in the possession of the trustee actually belongs to a third person, that property should be restored to the third person." Kutcher v. Liskey (*In re* Universal Medical

significant, however, are the factual and legal similarities between the third case, *In re Farmers Grain Exchange*,[111] and *Cox Cotton*. In both cases, banks were issued warehouse receipts as collateral for loans and claimed their pro rata share of the stored grain. In *Farmers Grain*, the bank had received payment for its alleged share from the bankrupt just prior to the filing of the petition. After analyzing the bank's position,[112] the *Farmers Grain* court held:

> A creditor who did not deliver grain to a warehouse company and who was issued warehouse receipts as security for money loaned is not entitled, upon the insolvency of the warehouse company, to participate in the distribution of the grain in the warehouse with the true owners holding warehouse receipts for corn actually delivered. Under the [Uniform Commercial] Code, a security interest is not enforceable against third parties and does not attach unless the debtor has rights in the collateral. I find that the payment the Bank received in consideration of its warehouse receipts was preferential.[113]

Serv.), 460 F.2d 524, 526 (3d Cir. 1972). *See also* Clemens v. Clemens (*In re* Clemens), 472 F.2d 939, 942 (6th Cir. 1972) (right to reclaim real property by equitable title holder); *accord* United States v. Luther (*In re* Garden Grain & Seed Co., Inc.), 225 F.2d 499, 504 (10th Cir. 1955) (milo and wheat held by grain company as bailee and distribution to warehouse receipt holder held not to be preferential transfer); Sandack v. Tamme (*In re* Hatfield), 182 F.2d 759, 762 (10th Cir. 1950) (consigned merchandise described in petition for reclamation was not forfeited to trustee); *In re* Hedgeside Distillery Corp., 123 F. Supp. 933, 950 (N.D. Calif. 1952) (on an estoppel theory, producer of 900 barrels of distilled alcohol allowed to reclaim from bankrupt warehouse where it was stored for aging), *aff'd sub nom.* Anglo Calif. Nat'l Bank v. Schenley Indus., Inc. (*In re* Hedgeside Distillery Corp.), 215 F.2d 651 (9th Cir. 1954) (mem.). *But see* Rotterdam v. General Mills, 245 Iowa 229, —, 61 N.W.2d 718, 720 (1953) (presumption in Iowa that, absent contrary expression of intent, delivery of grain to warehouse is a sale).

111. George v. Union Bank & Trust Co. (*In re* Farmers Grain Exch., Inc.), 10 COLLIER BANKR. CAS. (MB) 1 (Bankr. W.D. Wis. 1976).

112. The record reflects the following testimony:

> It appears that Green [vice-president of Farmers Grain Exchange] had considerable difficulty in attempting to explain the ways in which the bankrupts' contracts with farmers for the sale of their corn worked. According to his testimony, there was no corn securing the Bank's warehouse receipts. As he put it, in contracts of that kind, "We are not dealing with corn, we are dealing with dollars." The receipts never "represented corn" but merely "a dollar obligation." Again, "there was no corn covered by this type of a warehouse receipt as a bushel, never. It has a dollar value."

Id. at 6-7.

113. *Id.* at 7 (citations omitted). *Accord* Central States Corp. v. Luther (*In re* Garden Grain & Seed Co., Inc.) 215 F.2d 38 (10th Cir. 1954), wherein it is stated:

> [O]ne [who] . . . obtains warehouse receipts from a licensed public warehouseman without depositing with such warehouseman any grain for storage . . . cannot be heard to urge with success that the receipts were validly issued under the act and therefore constitute sustainable basis for the assertion in bankruptcy of a right of reclamation, an equitable lien, or a preferred claim.

Id. at 43. *See also* First Camden Nat'l. Bank & Trust Co. v. J.R. Watkins Co., 122 F.2d 826, 827 (3d Cir. 1941) (holder of overissued receipts only entitled to right of action against issuer where receipts issued pursuant to security agreement and not as bailment); *In re* Farmers Grain Exch.,

Returning to *Cox Cotton*, it is difficult to understand why the case was remanded for a determination of whether the Debtors had sufficiently "substantial ownership rights"[114] in the stored grain to justify its sale since the Eighth Circuit had already characterized the Debtors' interest as "minute."[115] The case, nevertheless, being remanded, the failure of the Bankruptcy Court to allow reclamation in light of the case law to which its attention was directed, is equally incomprehensible. Neither the record nor the cited authority supports the sale of the grain on the basis of a "bona fide dispute" or on any of the other standards established by section 363.

V. PROSPECTS AND PROPOSALS

The Cryts incident deserves attention only because it is the most dramatic in a rapidly increasing[116] number of controversies surrounding grain warehouse insolvencies.[117] Various state sponsored proposals have received considerable attention as a means of providing funds through insurance or bonding to cover potential losses suffered by farmers when warehouses become insolvent.[118] These proposals may

Inc., 1 BANKR. CT. DEC. 1621, 1622 (Bankr. W.D. Wis. 1975) (if there is a bailment, the title to stored corn did not pass to the bankrupts, and the proceeds from the trustee's sale must pass to the claimants on a pro rata basis).

114. 647 F.2d at 778.

115. *Id.* at 774.

116. An officer of a major grain warehouse and bonding company recently stated that "[w]e've had as many losses in the past 14 months as in the previous 14 years." Whitsitt, *Speculation is factor in elevator failures*, Farmland News, Apr. 30, 1981, at 1, col. 4. A United States Department of Agriculture official disclosed that "[g]rain bankruptcies have tripled in the past 1-1/2 years. . . ." Whitsitt, *Elevator bankruptcies leave grain farmers with everything on their side but the law, id.*, Mar. 31, 1981, at 4, col. 4. Mr. Cryts and others have compared the present condition of many elevators to the position of many banks in the early 1930's. *Let's stop these elevator losses*, Farm J., May 1981, at 48, col. 2.

117. Four factors that have been cited as contributing to the increased number of elevator bankruptcies are inflation, high interest rates, increased speculation and greater market fluctuations. Because they are small, these elevators have difficulty competing with larger institutions in the battle for increasingly scarce and high-cost credit. Because they are isolated from major trade centers, the rising costs of transportation have had an impact beyond that which has affected the overall economy. Furthermore, due to the increasing financial sophistication of American commodities producers and warehousers, more farmers and elevator operators are entering into futures contracts in a speculative attempt to get more than the prevailing price and beat inflation. At the same time, the government's role in stabilizing prices has declined since the Russian grain sales of the early 1970's, and commodity market prices have subsequently fluctuated within a broader spectrum. Thus, increased speculation during a period of inflation, high interest rates and increased price fluctuation have had the cumulative effect of undermining the financial stability of many grain warehouses. *See* statement by USDA quoted in Lilley, *Oklahoma Feed Dealers Ask Warehouse Change*, The Enid [Okla.] Morning News, Aug. 23, 1981, at D1, col. 6; and statement by Rolland Hendricks of the USDA National Warehouse Service Center, quoted in *Speculation is Factor In Elevator Losses*, Farmland News, Apr. 30, 1981, at 17, col. 1.

118. Two proposals have received considerable attention. Prompted by an earlier grain scan-

reduce the impact of grain warehouse failures. Unfortunately, no matter how stringently states may regulate their warehouses, bankruptcies will continue to occur. Thus, federal legislation is the only means of directly addressing and providing protection against the uncertainty and delay encountered by warehouse receipt holders in the type of situation presented in *Cox Cotton*. Federal legislative protection for those who suffer particular, adverse consequences from others' filing or adjudication of bankruptcy is not unprecedented when viewed against the backdrop of the new bankruptcy system being implemented under the Code.

By passage of the Bankruptcy Reform Act of 1978,[119] Congress intended to expand the authority of the bankruptcy courts, increase the efficiency of the system, and afford the bankrupt greater protection by a swift and final administration of his affairs. However, the Code continues to protect, for example, the right of secured creditors in aircraft[120] and rolling stock[121] to maintain control over the property during reorganization proceedings. The Code also extends new protection to the customers of commodity brokers undergoing liquidation by assuring the return of any "specifically identifiable security, property, or com-

---

dal, the Oklahoma legislature created the Oklahoma Grain Storage Indemnity Fund, which insures grain elevators in much the same manner as the Federal Deposit Insurance Corporation insures banks. OKLA. STAT. tit. 2, §§ 9-41 to -47 (Supp. 1980). Kansas, on the other hand, maintains substantial bonding requirements for grain warehouses. KAN. STAT. ANN. § 34-229 (1981). *See also* statement by Sam Reda, chief of the grain warehouse division of the Kansas Department of Agriculture, in Whitsitt, *Speculation is factor in elevator failures*, Farmland News, Apr. 30, 1981, at 17, col. 3. The Kansas approach is most appropriately tailored to fit the needs of states which have large numbers of producer cooperatives. The Oklahoma approach is best suited to insure the customers of privately owned, independent elevators.

119. SEN. REP. NO. 989, *supra* note 36, at 17. The report states:

> A major impetus underlying this reform legislation has been the need to enlarge the jurisdiction of the bankruptcy court in order to eliminate the serious delays, expense and duplications associated with the current dichotomy between summary and plenary jurisdiction, a wasteful remnant of the referee system left over from the pre-Chandler Act era.

Id. *See* McNutt, *The New Bankruptcy Court Under the Bankruptcy Reform Act of 1978: The District Court's Little Brother Grows Up*, 39 FED. B.J. 62 (1980).

120. 11 U.S.C. § 1110 (Supp. III 1979) states:

> The right of a secured party . . . in . . . aircraft . . . to take possession of such equipment in compliance with the provisions of a purchase-money equipment security agreement, lease, or conditional sale contract, as the case may be, is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession. . . .

Id. § 1110(a). This section modifies former sections 516(5) and 516(6) by giving the trustee in a reorganization case an opportunity to continue in possession by curing defaults and by making the required lease or purchase payments within sixty days. 11 U.S.C. §§ 1110(a)(1) and (2) (Supp. III 1979).

121. Section 1168 uses language identical to section 1110(a) in providing protection for owners of rolling stock. 11 U.S.C. § 1168 (Supp. III 1979). See *supra* note 120.

modity contract to which such customer is entitled. . . ."[122] Legislation has been proposed which would extend similar protection to present owners of existing commodities who are customers of grain warehouses.[123]

The proposed legislation establishes a ninety day timetable for identifying ownership interests, selling the stored produce, conducting hearings on disputed claims, and distributing the proceeds to the owners on a pro rata basis.[124] This timetable can only be extended by a single twenty day stay of proceedings pending an appeal.[125] This stay will not be extended for an additional period of time unless the requesting party demonstrates the likelihood of the appeal's success to the satisfaction of the bankruptcy court.[126] The legislation also proposes that the trustee be either the state official charged with grain warehouse reg-

122. 11 U.S.C. § 766(c) (Supp. III 1979). The need for this type of protection is explained by the congressional report accompanying passage of the Code:

> The rapid growth of the commodity futures markets in recent years has made the development of statutory guidelines for commodity broker insolvencies all the more imperative. According to the Commodity Futures Trading Commission . . . "[t]he Commission now regulates an industry where the value of commodities for which contracts were traded in 1977 exceeds one trillion dollars. . . ."

SEN. REP. NO. 989, *supra* note 36, at 7. The report goes on to highlight the "fundamental principles" underlying the establishment of special commodity broker provisions:

> First, customer claims are granted the highest priority against the bankrupt's estate . . . .
>
> A second basic objective . . . is the protection of commodity market stability. . . . [T]he trustee of an insolvent commodity broker does not have the luxury of an extended period within which to analyze the debtor's business and determine the best course of action. Delay by the trustee . . . could have a ripple effect that disrupts the entire market.

Id. at 7-8. The anomoly present in the Code is that many of these same conditions are present with regard to the failure of grain warehouses.

123. Senator Robert Dole (R.-Kan.) and Representative Bill Emerson (R.-Mo.) have introduced legislation that would clarify the status of stored grain and set a 110-day deadline for settling disputes. *See* S. 1365, 97th Cong., 1st Sess. (1981); H.R. 3984, 97th Cong., 1st Sess. (1981). S. 1365 passed the Senate by a unanimous voice vote on December 8, 1981, as a rider to H.R. 4482, 97th Cong., 1st Sess. (1981). Hearings on H.R. 3984 began in March 1982 before the Monopoly and Commercial Law Subcommittee of the House Judiciary Committee.

124. H.R. 3984, 97th Cong., 1st Sess. § 6, at 3-10. Section 6(a)(1) of the bill requires the trustee to determine the identity of warehouse receipt holders and secured creditors within 10 days after the filing of the petition. Section 6(a)(2) provides that the trustee shall inventory the debtor's assets within 30 days after the filing of the petition and "then sell such farm produce for its then current fair market value, and place the proceeds of such sale on deposit in an interest-bearing account. . . ." Under section 6(a)(3), the bankruptcy court must conduct a hearing, after notice to interested parties, within 60 days after the petition is filed "at which all requests for abandonment of the proceeds . . . shall be heard and determined." Section 6(a)(4) directs the bankruptcy court to order the trustee to "effect abandonment of the farm produce proceeds" within 90 days after the petition is filed and requires that the actual distribution of proceeds to commence within 20 days.

125. *Id.* § 6(d), at 13.

126. *Id.*

ulation, or the Administrator of the Agricultural Marketing Service of the United States Department of Agriculture, depending upon whether the facility is licensed by a state or the federal government.[127] As proposed, this legislation further provides for the distribution of proceeds from the sale of the produce regardless of the effect on any existing or proposed plan of reorganization under chapter 11 of the Code.[128]

While this legislation does not permit a right of reclamation, it does provide a swift and certain mechanism for settling the type of dispute encountered in *Cox Cotton*. Furthermore, it ensures that the trustee is knowledgeable regarding the industry and that the stored produce is not held hostage to an attempt to reorganize the financial structure of the storage facility. These reasons recommend the passage of this legislation.

VI. CONCLUSION

This Note has addressed the manner in which the Code and case law were misapplied under the circumstances presented by *Cox Cotton*. Good arguments remain available to counsel for receipt holders who are seeking to reclaim their grain. However, a more comprehensive solution to this problem requires legislative action. The reasons are compelling for additional legislation which will address the problems underlying the rights of commodity producers to have their claims speedily determined or their grain quickly returned in the administration of the estate of a bankrupt warehouse.

Gerald Ediger

127. *Id.* §§ 6(g)-(h), at 14-16.
128. *Id.* § 6(e), at 13-14.