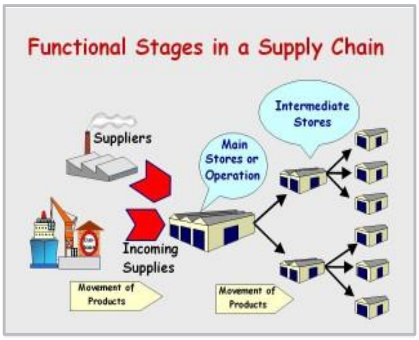
BANKERS GUIDE TO SECURE LENDING

WAREHOUSE RECEIPTS, ORDER OR STRAIGHT BILLS OF LADING,

OTHER NEGOTIABLE AND NON-NEGOTIABLE DOCUMENTS OF TITLE,

INCLUDING WAREHOUSE AND BAILEE OR DOCK RECEIPTS






Contents

A discussion on Warehouse Receipts, Order or Straight Bills Of Lading, Other Negotiable and Non Negotiable Documents of Title, Including Warehouse and Bailee or Dock Receipts.

1. Definition of title documents

Order or Straight Bills of Lading, other negotiable and non-negotiable Documents of Title, including Warehouse, and Bailee or Dock Receipts are documents of title that allow the person in possession to receive, hold, and dispose of them in the normal course of business, including the control and disposition of the underlying goods.

These documents are issued by or to a bailee and cover goods in its possession that are fungible or able to be identified. The Warehouse Receipt, however, does not represent ownership of the merchandise. It offers the bank control over the movement of the merchandise, and the bank must maintain control over the goods until they are released.

If the borrower defaults on its loan, the bank may have difficulty taking possession of the goods without proceeding through legal channels. If prior lines exist on the goods or clear title does not exist, the bank can face exposure even though it has possession of a warehouse receipt.

1.1 Categories of Documents

The above documents are also considered **Commodity Paper**, which falls into two categories, negotiable or non-negotiable. Documents of title include order bills of lading and bailee or dock receipts as well as warrants, warehouse receipts, and general orders for the delivery of goods can be considered non-negotiable or negotiable. Documents of title include any other documents that, in the ordinary course of business, enable the holder to receive and dispose of the documents and underlying goods as it pleases. To be considered official, such a document must be issued by or addressed to a bailee (holder such as a warehouseman) covering the goods. The goods in question should be identified specifically in the documents or be identified as a fungible part of an identifiable mass. For this document to be considered a registered receipt, it must be in deliverable form in accordance with exchange regulations, and it must be issued in negotiable form. It can be accepted without question by a buyer.

2. Warehouse Receipts

Ordinarily, underlying inventory is controlled by warehouse receipts of title. This receipt should be issued in consecutive numbers, for goods that are frequently stored in a warehouse. It acknowledges receipt of the goods and agrees to their safe custody and delivery upon surrender of the receipt properly endorsed. Often, such receipts are referred to as “public” warehouse receipts because they are issued by independent third-party controlled (public) warehouses. This means such facilities are bonded and available to the public, as opposed to privates’ warehouses which may be owned and used only by the borrower or a related company for their own products.

Always the Collateral Controller and the banks shall verify unpaid and due storage charges outstanding on merchandise prior to issuance of the warehouse receipt.

And also, continue to verify **unpaid warehouse charges** while holding receipts, as this can affect **the bank’s margin of perfection**.

In some instances, you may be able to arrange to have copies of storage bills sent to the bank, making it possible to monitor and enforce payment. Consider obtaining warehouse invoice copies to assure that warehouse charges are being paid. Public warehouses should be bonded. This offers greater assurance or protection of the goods to clients.

3. Public Warehouses

Public warehouses must be licensed under the relevant Warehouse / Warehouse Receipts/ Regulation or Act, which requires the posting of a bond. They must meet specific minimum security standards and other legal requirements to qualify for bonding. Bonded warehouses are certified by the regulators, and goods are protected by guaranty from the regulators. The regulators assure that all taxes and duties are properly paid on stored goods.

The warehousemen operating public facilities are considered independent bailees for hire. They perform the necessary functions of receiving, storing, and delivering goods in accordance with instructions from the owner, or the bank, in case the goods represent the bank's collateral. The warehouse has a prior lien to goods for unpaid charges. The warehouse receipts indicates storage and handling charges on its face, commonly excluding non-negotiable receipts issued by field warehousemen.

The use of a public warehouse may also prove beneficial for the proper segregation of goods. Goods that may involve liquor or other distilled spirits and pertain to agricultural commodities may require a special bond against withdrawal and a special license for the issuance of Warehouse Company for space necessary to store its goods, along with a storage or bailment contract or agreement. You should receive copies of the agreements and scrutinize them for charges, availability, and use of facilities.

3.1 United States Warehouse Act (Example)

In United States the uniform warehouse Act requires proper uniformity and controls regarding the storage of agricultural products. It also allows farmers and other dealers in commodities the distinct advantage of arranging credits, since a bonded warehouse offers lenders more collateral protection. Federally bonded warehouses must also meet specified Department of Agriculture regulations. The federal act requires warehouses to be inspected regularly relative to storage facilities and records. It prohibits certain other acts by the warehouse, while enforcing penalties for regulatory violations.

4. Loans on Warehouse Receipts

Loans against warehouse receipts are generally made on staples or standard commodity products that can easily and readily be marketed. The typical warehouse receipt loan is for a percentage of the estimated value of the goods used as collateral.

Loans on warehouse receipts, therefore, may be made on commodities in either a raw or finished state relative to merchandise stored in public or field warehouses. Borrowers often consist of processors or distributors of goods, including manufacturing of seasonal products.

4.1 Dealing with Warehouses

The bank should take necessary precautions when dealing with a new warehouse or Collateral Control company, because it may have to rely on the warehouse to deliver the goods to it or to the holder of the receipt in case of default by the borrower. Scrutinize the standard warehouse receipts form to determine its acceptability. The warehouse should also be investigated for reputation and management responsibility, Also check with other banks and lenders who have used this warehouse or Collateral Control Company.

4.2 Warehouse or collateral management Insurance Policies

Insurance policies carried by the warehouse owner and Collateral Control Company should be reviewed by the bank. A bank should make sure that the Warehouseman carried sufficient legal liability insurance with limits no less than USD 10 million and that the Collateral Control Company's carries professional liability insurance which incorporates insurance for fraud by employees and is of a substantial value in order to cover the Bank for any losses that may be proven to have been incurred as a result of negligence or willful misconduct or breach of duty. These insurances will also protect the bank against any losses caused by forged receipts and coverage relating to the value of the goods stored as well as negligence caused by the warehouseman or collateral controller in providing their services. Limitations and exclusions should be reviewed as these can have an effect on the recoverable amount. Also, cargo losses should be covered fully for the entire contents of the warehouse which assuming this liability.

The warehouse or Collateral Control Company's capacity to perform together with adequate insurance protection is necessary in case the bank has to rely on this secondary source of payment to protect their interests.

To summarize, the warehouse owner should maintain coverage **for legal liability**, **fidelity coverage**, third party **public liability** and **property damage**. **Legal liability protects** against losses for non-compliance of the warehouse with its legal responsibilities, while **fidelity coverage** insures losses caused by acts of dishonesty or fraud by warehouse employees and even intentional alterations of warehouse receipts.

The public liability and property damage policy covers liability for body injury or death to warehouse or Collateral Control personnel as a result of warehouse receipt activity. In addition, it includes protection against liability involving personal or real property damage that normally excludes the merchandise in the warehouse.

Obviously, the type of insurance that is necessary depends on the goods being stored.

4.3 Warehouse Receipt Collateral

The pledge of warehouse receipts offers the bank a security interest in the underlying goods so stated in the receipts, subject to any other valid and pre-existing liens.

Therefore, the bank should assure itself that **the merchandise has been fully paid for**, that no outstanding liens exist against the commodities, and that the goods have not been received on consignment.

This should be reflected on the receipt or in some form of receiving record, **by wording to the effect that the depositor has good rights to the merchandise. It should be confirmed by the signature on the receipt.**

While the receipt may accurately disclose the quantity of goods (**Number of Bags**), it is not a guarantee of quality (grade), weight, or title. Furthermore, a warehouse receipt does not necessarily protect you against loss or damage of the commodities nor warrant that the contents of boxes or containers match the description on the face receipts.

If a receipt reads “said to be or contain,” this excludes liability to the warehouse or Collateral Control Company and to warehouse receipt holders for the non existence or the improper description of the merchandise. However, if such wording is not indicated on receipts, the warehouse company remains liable.

All goods assigned as collateral moving in and out of the warehouses should be accounted for with such receipts, thus furnishing the lender an exact accounting at all times. Release of goods should be based on strict adherence to instructions provided to the warehouse or Collateral Control Company by the bank.

This is followed up with a “confirmation of delivery” from the next day by the warehouse or Collateral Control Company of the goods released the previous day. The bank should also receive a remittance of the goods released and evidence of an invoice for the sale of the goods.

4.4 Collateral Transition

Your lien should continue into accounts receivable until goods are sold. This means that your loan facility should account for an inventory portion on the line while you are holding warehouse receipts, which are converted to the receivables portion of the line once merchandise is sold. If there is much activity in the credit, consider using a cash collateral account which should be deposited in your bank. The proceeds can be debited on specified days throughout the week or month and applied to debt intermittently rather than immediately crediting them to debt as they are received.

Therefore, warehouse receipts collateral consists of documents issued by the warehouseman or Collateral Control and addressed to a bailee or receipt holder regarding the goods in the warehouseman's possession, which can be specifically identified or represent fungible portions of a larger identified mass.

5. Dealing in Negotiable and Non-negotiable Warehouse Receipts

Warehouse receipts are often issued in negotiable form, in that the face of the certificate indicates that the goods will be delivered to the bearer or to the order of some person or entity. If there is no such indication, the receipt is non-negotiable; it should be issued in the name of the bank to which the goods must be delivered, if required. The bank has to endorse non-negotiable receipts in order to transfer them in addition to notifying the warehouse or Collateral Control Company.

Practically speaking, this normally does not happen; the bank or its authorized designee usually has goods released by providing written instructions to the warehouse or collateral Control Company. Negotiable warehouse receipts should be endorsed to the bank and held until presented to the warehouse company in order to obtain the release of the goods**. However, many banks prefer dealing with non-negotiable warehouse receipts.**

5.1 Receipts Requirements

The receipt should meet the minimum following requirements:

- Location and any lot number where goods are stored.
- Date of receipt issuance
- Whether goods will be delivered to bearer or a specific person or their order; or a statement that the goods are being held for the bank if you are dealing with a nonnegotiable receipt.
- Storage and handling charge rates.
- Complete description of the goods or the packages containing them, including code numbers and units of measure, such as cartons, pounds, and case length.
- Proper signatures of the warehouseman or his authorized representatives evidenced by their specimen signatures on file and any ownership the warehouse has in the goods.
- A description of any loans, liabilities, or existing charges whereby the warehouseman claims a security interest or bailee's lien against the goods.

5.2 Verification of Signatures

Receipts should not be accepted if they have any erasures or other corrections. Verifications of warehouse representative signatures on the face of receipts are very important. Thus, the need for the specimen of the warehouse representative's signature must be on hand and checked out by the bank against each executed receipt.

5.3 Releases

The bank, in turn, must furnish the warehouse or Collateral Control Company approved specimen signatures of the bank loan officer authorized to execute releases of goods. The bank may approve blanket release authorizations relative to delivery. This can involve the release of merchandise up to a specified level or amount over a specified period of time. The bank should still confirm the approval of delivery of merchandise. The release of goods should be made with the understanding that the risk is high. **Trust receipts** can be used, although the banks may in reality be in an unsecured position with them.

5.4 Warehouse Ownership in Goods

In some instances, the warehouse may have an ownership in the goods, whether by itself or in common with others. Then you need to obtain proof of ownership. Also, if others have an ownership in the goods, have them consent to the assignment of the goods.

5.5 Storage

The storage of commodities is undertaken in two forms. One is the stack and lot number, which can readily identify exactly the same goods that are deposited and then withdrawn.

The other involves fungible goods that are commingled and represent interchangeable merchandise.

Units of the same commodities are usually stored in common containers or tanks and are treated equivalently. Therefore, withdrawals are normally made based on the same grade, and depositors are treated alike as tenants in common. Substitution of merchandise should not be allowed. And if goods need to be replaced, then new receipts need to be issued and executed. Where possible segregation shall be made by criteria of grade and depositor

5.6 Documentation Factors

Negotiable documents of title, such as negotiable warehouse receipts, should be endorsed in blank and remain in the bank's possession at all times while loans are outstanding.

Check endorsements in order to determine that they have been executed by the pledgor/owner and that those executing them had proper authorization besides verifying their signatures.

Obtain confirmation letters from the warehouse or Collateral Control Company that receipts are, in fact, outstanding. If another bank is participated in the credit, obtain photocopies of receipts for your files.

Remember, the warehouse or Collateral Control Company may have a secret or bailee's lien on the goods in storage, including handling charges for any advances it may have made for the goods. So make sure all warehouse charges are paid. Obtain warehouse billing statements that support claims for advances or other liabilities on which it may claim a lien on goods; this should also be reflected in receipts.

A verification letter with an accompanying schedule should be sent by the bank to the warehouse before release of the goods requesting verification of receipts presented by the borrower to the condition of the goods is acceptable.

Or have bank personnel inspect the goods by opening containers or boxes. Make sure, if goods are maintained in cold storage, that the warehouse offers appropriate facilities. Cold storage warehouses must be capable of storing perishable goods under controlled temperature levels.

Also make sure that the warehouse carries adequate hazard insurance covering the value of any goods held, naming the bank "loss payee as its interests may appear."

6. Field Warehousing and Storage Services

The Collateral Control companies may be of significant assistance by offering the necessary controls which you generally would not be able to achieve on your own. This can enable you to make loans secured on certain assets that you might not ordinarily undertake. Hopefully, use of Collateral Controller tempers the lending risk, as the Collateral Control servicing company should offer a suitable means of monitoring and establishing proof of the collateral's existence on a constant basis. Independent Collateral Control companies can bond borrower personnel in order to provide accurate information, reporting, and control of collateral.

If public warehouse facilities are not used, Collateral Control Company may provide a necessary control of goods within private warehouse premises or yards what is define as a **"field"** warehouse service. They can do this by roping or fencing off collateral goods to segregate those being financed and by controlling their releases.

Field warehousing is the transposition of a public warehouse system and the obligations, directly to the client's warehouse which enables the owner of a stock of goods to pledge it as collateral for a loan and under the custody of a collateral controller. This concept implies the notion of bailment which means the transfer of the possession of goods by the owner (bailor) to another (the bailee)which shall therefore maintain notorious, continuous and exclusive possession of all the Goods, for particular purposes such as hiring, loan, pledge of goods, and the delivery of goods for carriage, safe custody or repair.

Therefore, field warehousing and storage service is a more adequate method for securing financing goods than public warehousing by bankers. Services include the segregation, inspection, accounting, release, and general protection of the goods. Ordinarily, a collateral control Company providing field warehouse service lease part of the borrower's or owner's premises and maintains the assigned goods under its control.

6.1 Segregation and Separation of Goods

The establishment of a field warehouse invariably involves the concept of bailment. In legal terms; field warehousing may be defined as the establishment of a valid bailment upon the premises of the depositor by a Collateral Control Company, thereby creating a change of possession and an effective pledge.

6.2 Legal Opinion

The issuer of the field warehouse receipts creates a legally independent warehouse within the borrower's premises by leasing the storage area, posting prominent signs giving public notice that the controlled area is operated by the collateral control Company. Controlling movements in and outfield of the warehouses, installation of locks (double lock kept by Collateral Controller and the borrower) and seals, management by the Collateral Control Company staff, in order to issue legally valid warehouse documents.

The principal competitor of Collateral Control Company providing Field warehousing Services as a method whereby a corporate customer can give security over stocks and similar assets to a lender is the floating charge. However, not only does the floating charge have many disadvantages, such as although the floating charge may be registered at a national registry, registration does not establish the priority status of a secured creditor's rights in the collateral against third parties, but Field Warehousing services have certain positive advantages in those areas where the floating charges is weakest. Thus: Field Warehousing enables the bank immediately to perfect its security. The floating charge, on the other hand, only "crystallizes" (that is, becomes fixed) if the customer goes into liquidation or makes default in payment of principal or interest or some other breach of the terms of the debenture occurs, and the bank thereupon takes some positive step to enforce the floating charge.

Field warehousing services provides the bank with both the organization and expertise to control its security: It has the guarantee of the Collateral Controller that if and when security is needed it will be there intact and available to be realized. The existence of a floating charge, on the other hand, gives no such guarantee and until it crystallizes will not prevent the customer disposing of all or any of the assets charged. The customer may therefore, unknown to the bank; realize his stocks and other current assets in order to meet pressing unsecured creditors, with the result that when the bank appoints a receiver the value of the remaining assets secured by the floating charge is totally inadequate.

The bank's security under field warehousing services has priority over other creditors except the Collateral control's lien for its charges and the claims of a landlord levying a distress for a rent. These risks may however be mitigated by the bank guaranteeing the collateral Controller fees and landlord rent whereas the landlord will sign a waiver of lien. The floating charge, on the other hand, is subject to priority by a variety of creditors both preferential and others. Preferential debts include not only wages and salaries and national insurance contributions but one year's taxes payable to the Inland Revenue (who are in practice often the largest creditor of all).

Other creditors which take priority over the floating charge are the landlord levying for distress, secured creditors in respect of their specific charges (as mentioned above) and judgment creditors who execute before the floating charge crystallizes.

A security perfected under Field Warehousing provided that it is not a fraudulent preference is unaffected by a subsequent liquidation however soon it may follow.

A Floating Charge can only be granted by a corporate customer. A floating charge has to be registered which may affect the customer's credit rating and may give information to third parties which the customer would not wish to be disclosed.

Companies are frequently subject to restrictions in loan agreements or debenture trust deeds which prevent those giving charges. In some cases this prohibition may not extend to pledges, depending on the terms of the particular restriction.

The Collateral Controller providing field warehousing services often posts signs on the premises, evidencing its control to all parties who enter the area. This is frequently accomplished by having a custodian oversee the storage of goods; the custodian releases goods to the borrower upon approval or order of the bank. The custodian is often an employee of the Collateral Control Company

Separation or the segregation of goods by a warehouseman creates a change not only in possession and control but also in title ownership. Therefore, besides creating the role of a lessor and warehouseman, respectively, you can also gain the benefit of having a bailor/bailee arrangement from a legal and collateral protection standpoint.

The field warehouseman should maintain a record of all the goods moving in and out of the warehouse under its control. The Collateral Control Company providing field warehousing services should also arrange to have its auditors come in on a regular basis to check and verify merchandise. You should arrange to obtain copies of these audits or at least evidence that they have been completed properly.

In order to separate or segregate the inventory under its control in the case of a lease, the warehouseman leases a designated area of the warehouse premises. Control is handled by posting signs, roping, fencing, and the use of locks and barricades, when necessary, to maintain goods properly under trust.

6.3 Collateral Control Employees

Typically, Collateral Controller providing field warehouse services employ one or more persons at the borrower's or owner's warehouse in order to receive and release the goods. The Collateral Control Company uses its own personnel to control the inventory.

The Collateral control Company employees are responsible and liable for issuing new warehouse receipts for goods as they move into the warehouse. Before goods move out, more requirements have to be met by the Collateral Control party, such as:

- Obtaining an acknowledged release order for delivery from the bank.
- Receipt of payment in cash or the equivalent based on an amount that meets the price release schedule authorized by the bank or under some sort of blanket agreement for release, as arranged between the bank and the collateral Control Company.

6.4 Periodic Inspections

Once the field warehouse arrangement is underway, the Collateral Control employees undertake periodic inspections of the goods and provide the bank with written reports evidencing types and quantities of goods on hand, together with other requested information. It is necessary for the bank to determine the quality and condition of the goods for itself, even though the Collateral Control Company acts as a custodian relative to reasonable care and quantity of goods available.

While the warehouse or Collateral Control Company is concerned with quantities on hand generally, most collateral control companies will not hold out to be held responsible for quality and weight depending on the term sheet, nor will it be accountable for the contents of the goods stored. The Warehouses or certain Collateral Control companies therefore protect themselves in this respect by writing "said to contain" into warehouse receipts. Therefore, the bank should make arrangements accordingly and hire a collateral control company that does offer this service or then arrange to inspect the goods directly to determine that they meet quality standards and weight, even though this may prove difficult, and undertake the inspection on a random or spot-check basis by withdrawing samples or obtaining the services of a collateral control company that issues the bank inspection certificates in conjunction with warehouse receipts. More frequent inspections should be made of perishable goods. The bank's inspectors should report any deviations from the norm and also report any unusual problems.

These inspections should include the following:

- Inspection of receipts is performed to make sure they are properly signed by warehouse representatives; verify the signatures of all warehouse personnel authorized to sign warehouse receipts.
- Inspection of the goods for deterioration, including their count. Confirm they agree with receipts based on quality and quantity.
- Inspection of the premises to make sure your goods are properly maintained; if in field warehouse, they need to be marked so they can be easily identified as your collateral.
- Signs, posts, or roping off of the area where the bank's collateral is maintained is necessary unless the goods are maintained in common tanks and are of a fungible nature.
- Inspection of all documents and releases determines what is on hand and what has been shipped. Releases should be posted properly on registers or to the warehouse

receipts themselves. This information may include items released and dates, along with the remaining items on hand.

- The accounting should include goods deposited that reflect description, cases or boxes, numbers, and release prices when applicable.
- Inspections should be made of insurance policies to make sure coverage is sufficient and that all guaranties or warranties are in force. Also, make sure coverage is properly extended to all locations where goods might be located.
- Examiners must review past warehouse charges and make sure they are all current and not delinquent. Any past due amounts should be subtracted from the collateral value.

6.5. Proper Bailment Capacity

The bank should assure itself that, if a Collateral Controller is being used to provide field warehouse service, it acts in a proper bailment capacity and has properly leased or subleased a portion or all of the warehouse premises evidenced by agreement. Warehouse receipts should reveal the legal capacity under which the field warehouse company is responsible for the storage of goods.

7. Subsidiary Warehousing

Borrowers also set up their own warehouses and obtain the necessary licenses to operate them. In such cases, the borrower storing only its own goods does not qualify as an operating warehouse "for hire" such as a public warehouse. This type of arrangement, when the borrower or related party owns the warehouse, is considered *subsidiary warehousing*. Obviously, receipts issued by such warehouses do not offer the bank third-party protection or control against other possible interests. Therefore, your collateral position is somewhat weakened because of no control by independent third parties on an arm's length basis.

8. Controlling and Maintaining Goods by Warehouse Receipts

Control of goods by a third-party warehouseman is arranged by issuing warehouse receipts, which represent the contracts between the field warehouse company responsible for the storage, control, and maintenance of the goods, and the borrower (who is the bank's customer) who must pay for this third-party warehouse service. The receipts issued by the warehouse company become a "document of title."

The bank must use its own due diligence efforts to determine that the borrower has good ownership in the collateral to be pledged and that there are no prior or existing liens – even though the field warehouseman issues its receipt.

8.1 Warehouse Responsibility

The warehouse company is not responsible for the title or true ownership of goods stored in its possession. The bank can accomplish title verification by examining the borrower's books and records along with public records for other collateral filings and/or recordings. Furthermore, the warehouse company does not obligate itself to be responsible for the quality and condition of the goods as received beyond maintaining proper security while the goods are on its premises. This also applies to shrinkages, shortages, and deterioration while in the warehouse. However, the warehouse may have deterioration responsibilities in some instances, e.g., when a refrigerated warehouse is used for the cold storage of meat. In this connection, if the warehouse were negligent or if it did not maintain the proper temperatures and the meat deteriorated, it would be responsible and liable. The warehouse also does not accept any responsibilities for the values of goods as stated on receipts.

While generally it does not take responsibility for weights and volumes regarding goods, in some instances the warehouse may take responsibility for – the release and delivery of goods based on weights and volumes as in the case of fungible goods that are interchangeable in nature and cannot be separated, segregated, or distinguished one from the other. This is more prevalent with public warehouses, where different grades of commodities, such as grains, are stored or with petroleum products maintained in common tanks. The parties storing goods under these arrangements execute agreements with the warehouse that their goods are being maintained in common with other owners' goods often based on grade and that the warehouse is responsible for the goods based on given weights and volumes.

Beyond the storage of fungible goods, warehouse companies normally only take responsibility for releasing and delivering the same number of units originally stored, with no reference to volume and weight responsibilities. Warehousemen generally will not take responsibility for casualty losses of goods on their premises. In instances where the warehouse company assumes liability for casualty losses in conjunction with accepted receipts, it should not be in excess of the amount stated on the receipt. This does not exempt the warehouseman from responsibility for the proper care of the goods while in its possession although the contingency may be limited to some dollar limit of storage charges or goods value with reference in receipts.

The warehouse company verifies that the goods delivered and stored comply with the description on the receipt. However, it is not responsible if the contents are not as actually stated on receipts and described on the outer coverings of the goods.

9. Negotiable Warehouse Receipts

Negotiable warehouse receipts are used with fungible commodities, such as grain, dried feed, and certain oils. Dock and gin receipts pertaining to cotton bales may also involve negotiable warehouse receipts. These receipts should be issued in the name of a party other than the bank. They should be endorsed in blank by the debtor and any predecessor title holder to the bank's order to make them negotiable instruments and offer the bank a holder in due course status. This imparts to the bank full enforcement rights regarding payment of the pledged document.

The underlying goods may only be released in full or in partial amounts to a specified party of its order or to the bearer.

If receipts are endorsed by parties unknown to the bank, require that the signatures be guaranteed by another bank or other acceptable parties. If in bearer form, surrendering the receipt transfers title. The physical receipt must be presented to the warehouse for the release of goods specified therein. If a partial release, the receipt needs to be presented to the warehouse for endorsement for the goods being released. If the receipt is lost, misplaced, or destroyed, it can only be replaced after an appropriate bond is posted.

Use insured registered mail when sending receipts. This procedure acts as further protection to the bank in realizing return on its collateral if the borrower enters bankruptcy or if a judgment creditor attempts to levy on the goods.

A negotiable warehouse receipt is, therefore, held and controlled by the bank. The ownership or collateral interest in the goods may then be transferred and endorsed over to other parties without disturbing the responsibility of the field warehouseman to the warehouse owner or borrower.

If it is necessary for the bank to endorse a negotiable warehouse receipt, it should be executed without recourse.

The endorsement should also be made without any warranties pertaining to the quality, title, and condition of the commodities as evidenced by the receipts. Remember, negotiable receipts should be payable to the order of a specified party or be in bearer form. Negotiable documents are so identified on their face; always take physical possession of these documents.

9.1 Document Handling

The negotiable warehouse receipt is used more prevalently when the ownership or collateral interest in the goods tends to change hands frequently without their actual physical movement. This creates the need for careful handling of these documents, especially in view of their negotiability. In case such a receipt is destroyed, lost, or stolen, only a court order requiring a bond posting will allow the release of goods. If receipts have to be mailed, make sure they are insured and sent with proper instructions by registered mail, return receipt requested. By having warehouse receipts, the bank is assured of third-party control and verification of collateral values based on the description of the receipts; release of the goods is allowed only to bearer parties holding receipts evidencing the party so named in the receipt, or depending on whether the receipt is negotiable or non-negotiable. Any removals of goods when using such receipts should first be approved by the bank as lender.

The handling of negotiable receipts may prove cumbersome for the bank because of frequent releases. Therefore, the servicing officer or some agent should physically present receipts to the warehouse for release of goods. If this cannot be done, you may consider allowing the borrower to present the receipts under a trust receipt. It is imperative for the bank to follow up on the payment being made in full for the underlying goods and to make sure the warehouse receipts are returned within 21 days of their release as for example, allowed under the UCC.

10. Non-negotiable Warehouse Receipts

Non-negotiable warehouse receipts state that the delivery of the commodities will be to the order of the bearer or some specified party. They are commonly used by banks when financing a borrower's inventory and they should be registered and issued for the account of the bank. Non-negotiable receipts provide that the goods be released pursuant to written instructions of the bank, which is named in the receipt. If the receipts are issued in any other name, they must be reissued in the bank's name in order for the bank to perfect its security interest before making advances. These receipts specify to whom the merchandise is to be delivered, stipulating that they cannot be negotiated to others. The receipts should be marked clearly on their face that they are "non-negotiable" or "not negotiable." Such receipts are generally issued in the bank's name and should be written to be held for the benefit of the bank.

The bank should only take such receipts as collateral if it is so named in them as the party having the sole right to possession of the goods. The receipts should be registered in the bank's name in order for it to control delivery and releases of goods.

The receipts should always reveal from whom goods have been received. Title to non-negotiable receipts is not negotiated but is transferred by assignment.

Unless the bank assigns the receipts to a third party, non-negotiable receipts of themselves have no value. Non-negotiable receipts are more convenient for the depositor or holder to deal with than negotiable receipts because they do not have to be surrendered to the warehouseman before the merchandise is delivered. At times, warehouse companies may issue non-negotiable warehouse receipts against the surrender of negotiable warehouse receipts.

The bank as pledge may allow releases of the goods by its written order. Usually, the bank pre-arranges with the warehouse to allow goods to be withdrawn on a blanket release basis up to a certain dollar limit. Such pre-arranged releases usually stipulate that payment must be made within a certain short time before further releases will be allowed. Release schedules under a blanket arrangement allow the borrower more flexibility by not creating delivery delays.

11. Bankers Acceptances

These acceptances are actually drafts drawn by the trade or inventory owners. They are, in turn, accepted by the bank by writing or stamping "accepted" across the face of the drafts. The acceptance of the draft by the bank creates an instrument by reason of the bank's obligation to pay against it. Such instruments can then be sold to investors in the open market. Oftentimes, if a sight draft is accepted, the bank discounts it for the holder or the holder itself discounts it in the open market. Therefore, if the borrower needs financing under the draft in order to pay for goods, the bank accepts it and, in turn, discounts it or rediscounts it in the open market; it can even rediscount it with a Central Bank if the acceptance and the underlying goods meet certain eligible standards. Eligible goods must normally consist of readily marketable staples.

The bank can also use the proceeds to pay on sight drafts drawn by the beneficiary or to credit the proceeds to the borrower's account.

Such acceptances are secured by warehouse receipts or other negotiable documents of title, e.g., bills of lading that are attached to drafts. The Collateral Controller must be independent, reputable, and carry adequate insurance.

12. Loan Arrangements

Loans are often granted from a range of 50 percent to as high as 90 percent of cost or the selling price, depending on the commodity. Other factors that may have a bearing on advances are market demand, price stability, seasonal implications, if any, grade of merchandise, and effects of obsolescence or deterioration. Margins assure that the borrower has some equity in the transaction. Your margin of collateral to advances depends on the nature and marketability of the merchandise, price fluctuations, hazards, costs and expenses, and seasonal effects on values.

If you lend constantly to a borrower under a demand or revolving credit arrangement, you need to monitor your borrowing base closely for collateral margins in order to buffer price declines. You must also watch for dissipation in the quality of goods and possible liquidation expenses. Also, consider the state – raw or finished – and how it could affect liquidation values and ability to sell the goods. Consider the value of a repurchase from sellers or others.

Closely check the amount of goods out on release that have not been paid for and compare it to the amount of inventory equity cushion and against the borrowing base. This prevents you from overextending unsecured credit to the borrower.

The frequency of borrowing base reports or independent margin checks not only depends on the customer's borrowing and collection pattern but also on the particular type of commodity, market conditions, and price fluctuations. Therefore, release limits may be adjusted up and down in conjunction with borrowing base levels.

Other factors should be considered relative to maintaining an adequate collateral margin, such as monitoring price increases and declines of goods and deteriorations. Thus further adjustments to the borrowing base may be necessary. The advance formula may also be impacted by the stage of the goods. Consider obtaining repurchase agreements from suppliers when they are available. This might have a bearing on how much you are willing to advance.

Computer or manual records should be maintained on commodities. These records, to be sufficient, must include loan balances, dates, quantities, collateral types, and values and payment histories. The bank should use a "release order" form that describes quantity, including the description of the commodities and any special conditions for their release.

When non-negotiable receipts are issued, specific instructions must be furnished to the warehouse regarding the release of the goods covered by such receipts. Make sure the warehouse is furnished with specified signatures of bank officers authorized to execute releases of goods. Make sure the bank receives the original invoices from the purchase of the goods. The bank may allow payments to third parties against the delivery of documents, including the warehouse receipts, bills of lading, or to pay drafts with bills of lading or warehouse receipts attached.

13. Necessary Documentation

(1) Notes

Short-term, demand, or revolving notes should be used.

(2) Bills of Lading

Basically there are two types of bills of lading:

a) Order Bills of Lading. This is a negotiable title document that is issued by and acts as a receipt from the carrier or shipper of the goods. It also represents collateral, since it serves as a contract to deliver such goods and a title document for the party for whom it is drawn. This title document may be transferred to another party by delivery and endorsement and is usually made out to the order of the creditor or the shipper. The creditor or shipper can, in turn, transfer ownership of the merchandise to the buyer by endorsement upon payment in full.

b) Straight Bills of Lading. This document is non-negotiable and should not in and of itself act as collateral for a loan. It is also issued by a carrier or shipper to the buyer, who acts as a consignee. The buyer is allowed to obtain possession of the goods without surrendering the bill of lading since, under this type of arrangement, the buyer usually does not have to pay for the goods upon release (it has already established credit with the seller). The term *straight* comes from the fact that there is no third-party involvement, such as by a bank in the release of such goods.

(3) Warehouse Receipts

The warehouse receipt itself should reflect specific descriptive information, including the location of the warehouse where goods are maintained, receipt dates, and numbers. The receipt should also identify to whom the merchandise will be delivered, whether to a specific party or to its order, or to bearer.

Other information that should be provided includes verification of proper execution by approved warehousemen, storage charges, and descriptions of the merchandise.

(4) Pledge and/or Security Agreements

You need to control the storage of goods. Some banks use a separate pledge agreement to describe the documents, whether negotiable or nonnegotiable. The pledge agreements reflect the agreement by the borrower or owner with the bank; they may provide a description of any documents, the documents' serial numbers, who issued them, and any involved warehouse receipts of bills of lading so issued or in connection therewith. This agreement may include a description of the underlying arrangement that gave rise to the issuance of the documents via warehouse location and/or transportation of goods. Other banks may also use a separate security agreement for the underlying goods inventory behind the documents that describe the inventory by item and type, including any applicable purchase money lien rights.

This agreement may also be used to indicate taking of warehouse receipts, including warehouse receipt numbers. It could reveal the name of the storage agency, and to whom the warehouse receipt is being issued, whether it is in the name of the borrower or bank. The writer prefers to use a combined form for the pledge of documents and security agreement interest in the underlying goods inventory. A security agreement must be executed covering nonnegotiable warehouse receipts and underlying goods, including products and proceeds. Relative to negotiable receipts, even though possession controls, you should obtain a security agreement to further protect your lien interests in and to all the borrower's inventory and documents.

(5) Financing Statements

Filing of a statement, either in a central jurisdiction or in central and local jurisdictions for dual filing states, should be undertaken as a normal procedure for all types of documents of title, and especially for nonnegotiable warehouse receipts. While filing may not be necessary if the warehouse receipt is negotiable and remains in the bank's possession, it is still a good habit to file a financing statement as a catch all regarding a blanket lien interest in existing documents not held in your possession. This offers protection in case of lien challenges or it being relative to proper possession of goods by warehousemen.

Regarding non-negotiable documents, other ways to control and protect your bank's interest, besides filing, may be by giving the warehouse bailee notice of your security interest in the documents besides having them issued in your bank's name. Also, conduct proper searches under relevant legislation (e.g. by use UCC-11s) or through private search sources. Negotiable receipts should remain in the possession of the bank.

Some banks prefer to file financing statements as a precautionary measure against a claim a trustee in bankruptcy might make on the goods. This is also protection to the bank's perfected interest in the underlying merchandise that is stored or transported.

(6) Trust Receipt

If you do not have possession of documents or have a filing of record, you can still perfect your interest in negotiable documents for a certain period of time (e.g. 21 days under UCC) without filing, maintaining possession, or control. This is done by use of a trust receipt. However, this is considered virtually an unsecured interest even when taking a trust receipt with proper notice to the party issuing or holding documents. Therefore, the bank only retains a good collateral interest when it receives or maintains title to the goods, the documents, or the documents reflected in the trust receipt from someone other than the borrower.

The borrower should acknowledge the trust receipt, which is usually a standard bank form that acts as a release of the goods to the borrower or its designee. The form should address the specific purpose for the releasing of goods, including storing, loading, unloading, sale exchange, shipment, fabrication, processing, or conditioning. The receipt should also require the borrower to account for any sales proceeds or for the return of the goods and/or the warehouse receipt.

(7) Checking Warehouse Receipts

Receipts, whether negotiable or non-negotiable, should be complete in every respect as they pertain to warehouse locations, numbers, dates, goods descriptions, and signatures. Always check and make sure nonnegotiable receipts are issued in the bank's name.

(8) Warehouse Report

Monthly, the warehouse will furnish the bank with either a computer or manually-written report on the status of the goods held as collateral, reflecting all the additions and releases that should reconcile with the bank records. Differences must be rectified with the warehouse.

(9) Invoices

In some cases, when you are unsure of the real value of the underlying merchandise, request a copy of invoices of purchase along with warehouse receipts. The invoice terms and other details normally evidence ownership title to the goods.

(10) Notification Letter

Any time a negotiable warehouse receipt is issued and accepted as collateral by a bank, the bank should notify the warehouse company that the bank holds the company's receipt and is requesting that the warehouse subordinate any rights of the offset for unpaid charges to the bank's collateral interest. Attempt to have the warehouse or bailee acknowledge the bank's interest in the warehouse receipt and underlying goods. This protects you from another party withdrawing the goods from storage without your approval. In this connection, check the reputation of the warehouse, and inspect the goods to determine that they are being cared for properly.

(11) Collateral Receipts

These receipts should only be issued for negotiable warehouse receipts. Details specified in receipts should include names, receipt numbers, and dates, along with a description of the collateral.

(12) Hazard Insurance

The warehouseman or bailee will not maintain insurance on the loss of goods concerning warehouse receipts, except for negligence. Therefore, obtain appropriate insurance based on the type or merchandise you are warehousing. In addition, the warehouse will not take responsibility for fire losses and similar type coverage unless so stated on the face of the warehouse receipt. Therefore, always obtain fire and lightning insurance, including extended coverage – which should include windstorm and explosions. Additional special types of insurance may be required depending on the goods warehoused.

If value of commodities fluctuate very much, the borrower may use provisional reporting-type policies. If a provisional reporting policy is in force, make sure to receive and closely scrutinize and examine this policy and monthly reports. You must confirm and verify that the goods are being accurately reported. Therefore, these policies, which are usually provided in monthly reporting form, must be reviewed consistently for changing values and limits of liability at each different location where inventory may be stored. Also, make sure the goods are fully insured for replacement value at the different interval dates. Hold the original or a certified copy of the insurance policy covering the goods naming the bank as an insured "loss payee as its interests may appear," along with a loss payable endorsement. The warehouse company should hold a duplicate copy of this policy. Policies should include full mortgage clause provisions. The bank should hold the original policy or a certified copy. One of the advantages of having full mortgage provisions is that the bank will be notified prior to any cancellation of the policy. Require additional insurance when necessary pertaining to other types of risks. Insurance maturity ticklers should be set up by the collateral department.

(13) Blanket and Specific Release Letters

This letter of instructions is issued by the bank to the public or field warehouseman regarding dollar withdrawing limits on goods besides indicating when the accounting for payment of released goods is required. It should reflect the location and address of the warehouse, allowed release order, delivery dates, necessary signature information and method of valuing goods. Such releases are often used for revolving credits.

Specific releases of merchandise may be allowed regarding negotiable warehouse receipts upon presentation by the bank or its agent or upon request by the borrower which should simultaneously reduce its debt accordingly.

If all goods are to be delivered, the receipt will have to be surrendered to the warehouse, but for partial deliveries it should be endorsed each time. Movement of goods should be recorded on respective receipts.

This letter should be sent to the public or field warehouseman and a copy should be returned acknowledged. The letter should reserve all the bank's rights and remedies to the goods and not create any waivers thereto until the goods are delivered from the warehouse to the party to whom they are being sold and transferred.

(14) Signature Cards

You need signature cards executed by the party acting as the warehouse manager. If you are under a field warehouse arrangement, you need to have the signature of the employee acting on behalf of the field warehouse company and the signature of someone from the field warehouse authorized to undertake the responsibility of a bailor.

In addition, a signature card executed by the servicing loan officer and other authorized bank personnel should be furnished to the warehouse company. This card should specify blanket release details and other information on payment and handling requirements.

(15) Borrowing Base Certificates and Supplemental Collateral Margin Reports

A borrowing base certificate should be furnished as frequently as needed, whether weekly, when advances are made, or at the time new or renewal notes are taken. Also, supplemental collateral margin reports should be submitted constantly as new collateral goods move. These reports should reflect specific storage dates and when goods move out. Margin reports should be continually reconciled to borrowing base certificates in order to monitor and control acceptable loan to collateral levels.

(16) Draft Collections

Often the seller's bank sends sight drafts with receipts and other documents attached or enclosed to the buyer's bank for collection. If you are the buyer's bank, you may be willing to release the documents for inspection for a very short time, usually requiring them to be returned the same day against payment or refusal. The collecting bank often requires its customer to execute an agreement in this regard.

It should include hold harmless language and indemnification protection regarding loss of documents. Therefore, the only way to minimize the bank's potential liability if the released documents are not returned is to create an indemnification arrangement with its customer so that the customer will make good any losses incurred by the bank due to its release of the documents prior to payment. The bank should draw up a letter regarding such an agreement to be acknowledged by its borrower.

This should be followed up by having the borrower execute a receipt for each group of documents removed for inspection. It is best if the receipt lists the pertinent documents in the most identifiable manner possible.

Such a receipt could be in the form of a trust receipt, except that the term, trust receipt, usually refers to a receipt provided to the bank for the release of documents in which the bank itself holds a security interest. The bank does not really hold a security interest in the subject documents even though it does have a strong responsibility in acting as the collection agent for the buyer. Therefore, use of the term, receipt, should be sufficient for the document. Be cautious, because this arrangement does not reduce the bank's responsibility. The bank should make sure that the party with whom the arrangement is joined is strong enough financially to cover any losses that may be incurred.

(17) Delivery Forms

You should receive, at your request, delivery forms or other evidence of delivery, such as receipts confirming that goods have been properly delivered. In this connection, pertaining to the release of goods, check for the completeness of forms relative to release prices and payments. Also check signatures, as any forged signatures should be covered under the bank's fidelity policy. Appropriate copies of delivery receipts should be furnished the warehouse company and any third-party field warehouse company or personnel.

(18) Inspection Reports

Have bank staff review storage records and prepare monthly inspection reports. These inspections may provide statistical and factual data on your collateral. They may include:

- Spot checking and matching of commodities involving containers, cartons, boxes, or other items against warehouse receipts.
- Checking out warehouse liens for unpaid storage charges or for past due amounts owed for storage.
- Inspecting warehouse facilities relative to storage and general appropriateness, including signs, security systems, and management and control of premises.
- Verifying insurance coverage on commodities and making sure the proper type of insurance and enough of it is in force.

- Verification of proper segregation and marking of goods by use of stock cards or otherwise evidencing in whose account or name the goods are being held.

Note: All loan officers should be alert to unpaid warehouse charges because they can represent a "secret" lien prior to your first lien position. The warehouse company, in essence, is conferred a bailor's lien right for unpaid storage charges, which in the United States is not subject to the UCC.

The term, *secret*, is used because no filing requirements are necessary for the warehouse company or third-party field warehouse service to obtain such a lien. It is suggested you obtain a copy of paid monthly billings for this service from the warehouse company or from your third-party field warehouse agent.