WAREHOUSE RECEIPT FINANCING

BRIEF HISTORY DEVELOPMENT AND IMPLEMENTATION STRATEGY

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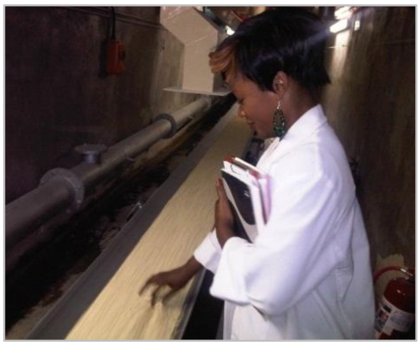


Forward

Before we commence our discussion pertaining specifically to warehouse receipts, it is important to enunciate certain general principles which are applicable to the financing of commodities and warehousing in general.[1]

There are two possible cause-and-effect relationships between the storage and the financing of goods; either the goods are placed in storage specifically to facilitate their financing, or their financing is necessary to meet the capital requirements imposed by the ownership of goods which must be warehoused in the normal course of business. Regardless of whether financing is incidental to storage or whether storage is incidental to financing, the relationships among the borrower, the lender and the warehouseman are much the same.

There is a very close connection between warehousing and goods financing. The unique aspect of warehousing responsible for this is that when goods are in a warehouse all of the elements necessary to the creation of a lien in favour of a lender are present. By proper documentation of the storage transaction, the lender can be protected just as effectively when the collateral is in the possession of a warehouseman, as he would be if he held the collateral himself.[2]

A lender can provide a loan using almost any kind of property as collateral provided it can hold an adequate lien upon the property. The most effective type of lien is that which is achieved by direct physical pledge of the collateral with the lender. As the lender has no facilities for storing and caring for large quantities of bulky items, it is instead possible for an independent warehouseman to serve the lender by acting as custodian for its loan collateral.

In making loans secured by goods in a warehouse, the lender is relying upon the warehouseman to protect and to preserve the goods. The selection of a warehouseman of competence and integrity is therefore just as important to the safety of the loan as is care in the selection of the types and quantities of goods that will be accepted as collateral. The lender must determine which organisation is most suitable to its needs. The lender must remember that the goods upon which he is relying on as collateral to his loan are "on deposit" in the warehouse just as much as his own customers funds are "on deposit" with him.

[1] For reasons that have been explained subsequently in this paper Section E, the principles relating to public warehousing are relevant to field warehousing as well.

[2] This is subject to the fact that all the essential elements of creating an independent warehouse on behalf of the lender must have been met. This will be addressed in more details in Sections A to L below.

The warehouseman may be regarded therefore as a “goods banker”, whose responsibilities to the depositors of the goods are just as great as are the responsibilities of the “money banker” to his depositors. The lender has a right to expect that the goods held under pledge to him will be treated with just as much care as the lender exercises over the funds of the public entrusted to his keeping. **If the warehouseman is not aware of the high degree of care expected of him, he is hardly a suitable custodian for goods serving as collateral to bank loans.**

After the lender has assured himself of the suitability of the warehouseman as a custodian for the particular goods to serve as collateral, he must determine the loan-value of the goods. In order to get his money out of the goods in the event of insolvency of the borrower, the lender would be obliged to make a forced sale. The lender must realise therefore that the current market value of the goods is only a point of departure from which he must arrive at the liquidation value of the goods by taking into consideration factors such, as the extent to which the current market-value may decline during the life of the loan, the amount which may be sacrificed due to the necessity of a forced sale, and the costs of liquidation.

After having passed upon the qualification of the warehouseman and having determined the loan value of the goods offered as collateral, there are certain other precautionary steps to be taken by a prudent lender before actually making the loan. He must be aware of the limitations upon the warehouseman’s legal liability and take appropriate steps to protect his interests in matters not falling within the responsibility of the warehouseman. Three such steps are: becoming satisfied that the borrower actually owns the goods free and clear; making certain that the goods conform to the description and obtaining adequate insurance protection on the stored goods.

The mere fact that the borrower has placed certain goods in a warehouse is not necessarily proof that he owns them. So, when the warehouseman is holding bank loan collateral - it may be the case that the person for whose account the warehouseman is holding the goods, may not be the owner of the goods. Therefore it is necessary for the lender to make certain that the borrower has good title to any goods offered as collateral. The lender must be sure that the borrower does not hold the goods as a mere agent; that there are no chattel mortgages recorded against the goods that they are not held under lease, conditional – sale contract, or consignment; and that they have not been stolen or otherwise misappropriated.

Having set out some general concepts relating to the financing of commodities and the need for warehousing such pledged commodities above, we will now be looking at “warehouse receipt financing” or “field warehouse receipt finance” in particular whilst establishing the critical link between the warehouse receipt and the underlying financing transaction.

Warehouse Receipt Financing

At ACE Global Depository, we receive many inquiries regarding warehouse receipts and field warehouse receipt financing. Such queries originate from bankers and other lending institutions who are in the business of extending credit on the basis of warehouse receipts issued in respect of underlying commodities/ products placed or to be placed within warehouses and which are pledged/ or to be pledged to the lender as collateral. *See Attachment 1 for Warehouse Receipt Financing Summary and Comparison with Chattel Mortgage.*

Such inquiries reveal the need to reinforce middle and back office team functions and capabilities and build an awareness of warehouse receipt middle office management and what it is, and the basic principles employed when conducting such field warehousing operations, as well as basis of the extension of credit backed by the warehouse receipt representing the collateral placed within the warehouse.

A. FIELD WAREHOUSING – HISTORY AND DEVELOPMENT

The Field Warehousing Receipt, like the trust receipt and the factor's lien may be looked at as a devise which came into being in the late nineteenth century and which was designed to make secured inventory financing possible. Field Warehousing is something which has managed to exist as a remarkable security devise (whether formally under statute or informally) for nearly a century before its discovery by the financing world as a means of securing a warehouse receipt and using it as a financial instrument.

The pre-institutional origins of the Field Warehouse rest in US case reports issued in the late 1800's and early 1900's[3] which established a unique position for professional and independent collateral control service providers acting as field warehousemen. In 1929 there were approximately 250 locations in USA under field warehouse, and by 1941 this number had increased to more than 6000 locations, operated by six leading companies as well as by a number of smaller warehousing companies, all of whom began to be entrusted with the responsibility of perfecting the lenders pledge by creating a valid bailment over the pledged goods.[4] The field warehouseman hence started to gain currency as a specialist who would perform independent custodial services with respect to the financed goods on behalf of lender institutions and thus marked an end to reliance on owner / customer issued receipts as being sufficient to

[3] E.g. Geilfuss v Corrigan 95 Wis. 651, 70 N.W 306, 37 L.R.A 166 (1897); First National Bank v Harkness 42 W.Va. 156, 24 S.E. 548 (1896) ; Security Warehousing Company v Hand 206 U.S 415, 461, 27, S. Ct. 720, 721 51 L Ed.1117, 1118 (1907);Philadelphia Warehouse Co v Winchester 156 Fed. 600,610 (D. Del 1907); American Can Co V Erie Preserving Co 183 Fed.96,97 (2d Cir.1910).
4 Financing Goods by Albert G. Sweetner (1957)

establish independent custodianship and to defeat the claim of the trustee in bankruptcy.

In a standard warehouse receipt financing arrangement there are three parties- the borrower, the lender and the warehouseman. The lenders who make use of this type of security are typically local commercial banks who do not have the expertise in dealing with either receivable or inventory, thus when the local bank makes a local loan on the security of the inventory (with or without the receivables) it is apt to call in the professional, and it will in all probability be wise to do so.

The duties and the potential liabilities of a field warehousing company is to act as a buffer between the borrower and the lender, and to be intimately involved in the financing transaction and by virtue of that involvement, know a great deal more about his client's affairs than a storage warehouseman does. The field warehousing company therefore occupies a unique position. Its link to the actual business of storage is merely incidental and it therefore plays a key role in reinforcing and protecting the security over the pledged goods as created by the lender.

It is unfortunate that modern day service providers have started to move away from the origins of field warehousing and have begun to place themselves more as storers or stock monitoring agents relying more and more on data and information provided by the borrower, rather than as true bailees and custodians of pledged commodities, exercising independent judgement and issuing specialist reports based on data and information collected autonomously on behalf of the lender.

Before we embark into our discussion pertaining to warehouse receipt finance and its practical implementation, it is important to set out the following important definitions to put matters in context.

B. IMPORTANT DEFINITIONS AND CONCEPTS

"Bonded Warehouse" means a secured facility supervised by customs authorities, where dutiable landed imports are stored pending their re-export, or release on assessment and payment of import duties, taxes, and other charges. This may also be called a customs warehouse.

"Public Warehouse" means a warehouse operated independently by a warehouseman who has no ownership interest in the stored goods and provides his service for a set fee. Should the warehouseman own some of the goods stored, that fact must be plainly stated on any warehouse receipt covering those goods.

"Terminal Warehouse" means a warehouse that is separate and distinct and consists usually of a large storage area serving a number of different businesses and is at a separate location owned and operated by an independent warehouse company. A terminal warehouse is used by businesses that require additional storage capacity since a terminal warehouse is geographically removed from the depositor's place of business.

"Field Warehouse" is essentially a bespoke collateral control structure where, by utilizing the same principles applicable to storage within public warehouses, a warehouse is created within the field, on the borrower's own premises which are being used for storage/ processing and where the borrower wants to keep the inventory or store goods being financed. The inventory serving as collateral is physically segregated from the borrower's other inventory and is strictly supervised by a third party collateral controller appointed exclusively by the lending institution in order to take possession and control, and to manage the collateral (either existing inventory or a new consignment) within the borrower's premises.

"Field Warehousing" essentially refers to a device to enable the owner of a stock of goods to pledge it as collateral for a loan. If properly conducted, it gives effect to a valid bailment and a creates a resulting security interest in favour of the Warehouse Receipt holder (the lender), in the inventory/ Goods which have been deposited into the warehouse which is owned or controlled by the borrower, and provides effective third party control and enables close regulation of the amount of the Goods which are to be made available to the Depositor for subsequent use or sale.

"Collateral Management" refers to a process whereby the owner of a stock of goods which are deposited into an independent, terminal or public warehouse, pledges it as collateral for a loan. Effective third party control is maintained through an arrangement reached between the storer and the collateral controller on the instructions of the borrower and with the consent of the lender.

C. WAREHOUSE RECEIPTS

A Warehouse Receipt is evidence of the relationship which exists among the parties to a storage transaction.

The law pertaining to a storage transaction: A storage transaction is a commercial relationship just as is a sale or loan. The rules governing commercial transactions, known as commercial law generally were not originated by legislative enactment. Instead they have developed out of a long series of court decisions each based upon a set of individual circumstances.

In this law are found provisions pertaining to two types of warehouse receipts; negotiable and non-negotiable. During the recent years the use of negotiable receipts has decreased markedly except in connection with the storage of goods traded on the commodity exchanges.

The legal nature of storage transactions: In the storage transaction the legal relationship between the warehouseman and the person for whom he is holding the goods is known as **bailment**. In a storage transaction the warehouseman is the **"bailee"** and the person for whom he is holding the goods is the **"bailor".**

In the simplest type of transaction there are only two parties to the transaction, the warehouseman and the owner of the goods. In such a case the non-negotiable warehouse receipt is a written acknowledgement that the warehouseman holds certain goods in store for the account of that person who is named on that document and the statement of the warehouseman's obligations to deliver these goods to that person. The term used in the traditional form of warehouse receipt to describe this person is depositor.

In a somewhat more complicated form of storage bailment the goods are "deposited" in the warehouse by some person other than the person for whose account they are to be held and to whom they are to be released. They may for example be placed in the warehouse by a supplier to the person who is entitled to withdraw the goods. Therefore there is a misconception leading to an error in terminology, that the bailor is automatically the owner of the goods.

There is still another type of storage bailment - used in connection with bank loans- goods are placed in the warehouse by the borrower or by his supplier. The warehouseman is asked to indicate on the receipt however that the bank is the person for whose account the goods are being held (as collateral to his loan). As the loan is repaid the bank authorises the warehouseman to release the portion of the goods to the borrower. In this type of situation it is quite common for the bank to be identified as the depositor, even though it never handled the goods themselves before during or after the period of storage.

It can be seen therefore that a non-negotiable receipt does not serve as a certificate or proof of ownership in the stored goods. It is merely evidence of the fact that the warehouseman has received the goods and is holding them subject to the instructions of the named party.

D. WAREHOUSE RECEIPT - USE AND PURPOSE

As already mentioned the storage of commodities within warehouses (whether in public, terminal, bonded or private field warehouses) is not a new concept and has been in existence for over 100 years now. There can and should be no claims that a new method of financing has now come to the forefront, but rather that new and sophisticated procedures have been developed to support such a method of financing.

Storing commodities in such warehouses has been for one of two purposes; for future need, or for credit. Frequently, storage is for both purposes especially on the part of traders and processors of commodities.

During the past years in many commodity producing areas there has been an increasing tendency on the part of the producers themselves to store for both purposes. When commodities are being stored for credit purposes, it has been the general rule that such goods should be surrendered into the custody of someone wholly independent of the one who stores it, or the owner of the goods. The person with whom the goods are stored is generally called a warehouseman. NOTE: If the warehouse is one which is owned, operated and controlled by a third party storer / operator, then the operations are deemed to be called **collateral management operations**. Where the warehouse is privately owned or leased by the borrower and operated without the involvement or control of a third party storer / operator, then such operations are deemed to be **field warehousing operations**. The following discussion will focus on field warehousing operations which are more common place in the trade today.

Ideally, the field warehouseman whilst acting as the collateral manager for the lender must not only reinforce and protect the security over the pledged goods **after** the underlying financing terms have been finalised, **but play a key role as a buffer between the borrower and the lender before** the lender finalises the terms of the underlying financing transaction. This is in order to ensure that the lending terms and strategy perfectly match the ground operations and the underlying transaction flow.

It is this function when properly conducted, which allows the warehouse receipt to assume its role as a financial instrument actually securing the lenders interests in the underlying commodities.

E. FIELD WAREHOUSING - GOVERNED BY PUBLIC WAREHOUSE PRINCIPLES DEVELOPED OVER TIME

Goods are placed in public warehouses and managed by independent custodians acting as bailees of the goods for a variety of reasons, one of the most important of which arises in connection with their financing.

It is necessary therefore to become familiar with the reasons that goods are stored in such warehouses, the study of the transaction flow, sequence of events, risks and mitigants, services to be performed, the documents used, the legal relationship created the relevant insurance and the pertinent law.

Reasons for storing goods in public warehouses: The need for storing goods arises because of an accumulation of excess stocks of goods at various points in production and distribution process, seasonal factors, aging and conditioning, economy in purchasing, prevention of goods shortage, mass production, fluctuation in market prices, strike protection,

Public warehouses stand ready at all times to handle and store goods owned by any business enterprise, provided that these goods are suitable for storage in the type of facilities available. Field warehousing, being an off-shoot of public warehousing, is governed by the same principles of law. **However field warehouses do not exist until the need for them arises.** They are created especially to meet certain specific requirements and those requirements only. Hence, under field warehousing, the owner of the goods, identified as the depositor, agrees to lease suitable premises to the field warehousing company and to pay for all services rendered.

The field warehousing company is not an ordinary lessor or storage provider or collateral manager. It is in fact intimately involved in the financing transaction and by virtue of that involvement knows a great deal more about the client affair than any ordinary storage warehouseman does.

In essence, field warehousing is a plan to store on the premises of the owner the very products on which he desires to affect a loan at the least cost to himself. The motive behind any field warehousing arrangement, as far as the borrower is concerned, is a desire on his part to enhance his credit. In other words, he endeavours to place his products in a position that will enable him to pledge them as collateral for a loan. Almost without exception as soon as the credit needs pass, the field warehouse arrangement also passes.

Placing the products in a credit or collateral position could be accomplished by placing them in storage in a warehouse. Most of the time, the owner of the products frequently owns or controls a warehouse or storage facility as the very nature of the business frequently obliges the borrower to have storage facilities nearby his operations whether by ownership or under a lease. Naturally the owner wants to use these premises to his greatest advantage. He may also wish to avoid unnecessary freight hauls by maintaining private premises. Further, he may feel that he can make sales and shipments to greater advantage from his own warehouse facility than from some other warehouse.

Field warehousing is therefore resorted to by traders or processors of products who can afford to maintain privately owned or leased warehouses.

F. WHAT REINFORCES A VALID FIELD WAREHOUSE

Field warehousing is sound if proper precautions are taken scrupulously to establish and to maintain the relationship of bailor and bailee. This means a meticulous observance of all the legal requisites essential to creating and maintaining such a relation. **Short-cuts on the plea of lowering costs have no place in field warehousing. The principle of disinterested custodianship must be strictly observed.**

In a field warehousing plan that can stand the crucial test, the customer (or association) should lease / sub lease the warehouse to a party who is in no way interested in or related to the customer (or association), to operate it as if it were a public warehouse. The warehouseman must take and must maintain actual possession of the building and the goods at all times. The lessee must exercise complete control and dominion at all times over the warehouse supervision and the products stored therein by virtue of a valid lease or sub-lease.

The possession of the company conducting field warehousing, must be exclusive, continuous, unequivocal, open and notorious, so that other creditors of the owner of the goods may not be misled and are put on notice of the lenders lien over the goods.

How is this usually done? A sufficient number of signs of such size as readily to attract the notice of the public, clearly indicating that the premises are in the control of the warehouseman, must be placed inside and outside the buildings or premises. They should appear at all points of entry and exit to the premises. This does not necessarily mean that the lessor must be completely denied access to the warehouse at all times, but it does mean that he must be denied access except in the presence of the lessee or his duly constituted agent, as in the case of other public warehouses.

The validity of the warehouse receipts could readily be attacked if it can be established that the customer had free access to the warehouse in the absence of the field warehouseman or if it can be shown that the customer entered at his pleasure, and sampled and inspected the goods in the presence of prospective buyers or moved them around and dealt with them, when neither the warehouseman nor his local custodian was present. That is not the kind of open, continuous, notorious, unequivocal, and exclusive control that the law contemplates.

What must at all times be remembered is that the **transaction is not changed by the form of the agreement under which it is cloaked.** The Courts will look at the **real purpose of the contract and not to the form or name given to it by the parties**. This means that all elements securing open, continuous, notorious, unequivocal, and exclusive control as set out above and in Section L below must be observed.

G. THE IMPORTANCE OF PROPER BAILMENT UNDER THE LAW

On the basis of the foregoing, a bona fide relationship of bailor and bailee between the depositor and the warehouseman, or the creation of a completely disinterested custodianship is always critical in the financing of warehoused products, and **it is essential in a field warehousing arrangement to separate ownership from possession.** Only if the warehouseman is wholly independent of the borrower can there be disinterested custodianship of the product.

The importance of disinterested custodianship of the product grows out of the fact that when the borrower offers the goods covered by the warehouse receipt to the lender as security for a loan he proposes to pledge the products in the warehouse covered by the warehouse receipt. It is the products that are therefore the real security. **It is essential to the validity of a pledge that the pledgor surrenders possession of the thing pledged**. **He cannot pledge an article and at the same time keep it.**

In other words, so long as the products are pledged as security for a loan they must remain in the custody and exclusive control of someone other than the borrower. **"The borrower and his collateral are best parted,"** and there is no absolute and unequivocal parting such as the law contemplates if the borrower has access to his collateral at his own pleasure or can exercise any control over it independently or in the absence of supervision of the warehouseman or the lenders appointed agent.

In testing whether there has been an absolute and unequivocal parting on the part of the borrower, the borrower must ask himself: **"***under the proposed form of warehousing, have I at any time access to the products other than in the presence of the warehouseman and may I at any time exercise any control of the products?* If the answer is in the affirmative to the slightest degree, possibility of lack of transparency exists.

Actual change of possession must exist in fact, and must be truly and absolutely carried out, as opposed to formal, potential, virtual, or theoretical change. The proof required to show actual change of possession is not measured by any fixed set of rules and dependence must be placed upon the facts and circumstances of each particular case. Usually the determination must rest upon the finding of the court or the jury after hearing the evidence adduced on both sides.

H. INDEPENDENT CUSTODIANSHIP – WHAT IS THIS?

We have already looked at the legal preconditions regarding the establishment of a relationship of bailor and bailee between the borrower of goods and the warehouseman, and the need for an actual transfer of possession of the collateral to the bailee.

In addition to this, the need for **complete independence between the storer and the warehouseman and his agents, is indispensable** if a field warehouse receipt is to stand the test to which it will be subjected if a question is raised as to its validity as collateral.

The requirement for “disinterest” has arisen over the years on the basis that the person/ customer/ borrower who is seeking credit, and is offering commodities as collateral, is not free from a conflict of interests which may enable him to serve as a disinterested custodian. A borrower who may also attempt to serve as the custodian of the collateral places himself in the position where reportedly "the dictates of self-interest will exercise a predominant influence and supersede that of duty."

I. WHO CAN SERVE AS AN INDEPENDENT CUSTODIAN?

Anyone who is competent to care for the goods that are to be stored, is credible, transparent and traceable in conducting its operations through adopting proper operating systems and procedures, is capable to bear liability and compensate for loss incurred if any, and is diligent, vigilant and independent of the storer in every sense.

When a warehouseman operates more than one field warehouse he uses at each building or warehouse a custodian who is supposed to be his employee / agent, and his only.

This custodian is the key player. He may make or defeat the whole operation. It is essential that he should be as free and disinterested of any borrower as the warehouseman himself. The degree to which he is disinterested may determine the validity of the receipts themselves.

Loans secured by field warehouse receipts covering currently salable merchandise are becoming more and more prevalent on the portfolio of banks and other financial or lending institutions. As the lender cannot take physical charge of the goods offered as collateral, a device is needed to give the lender the protection of the value of the merchandise. Field warehousing provides the means of getting this protection by providing a way of placing the goods in the hands of a disinterested and independent third party.

The third party in this case is the warehouse company operating what is known as a 'field warehouse'. The custodian is an integral and vital part of any field warehousing operation and it is therefore always highly important that the custodian arrangement be carefully scrutinized for the **custodian is the key man. He is the man who controls. If he fails, all fails.** No lender can afford to take any representations on this subject unless they are assured that the custodian is a wholly disinterested party which is competent to investigate.

Some key questions to ask the custodian to investigate him would be; what does he know about caring for the goods in storage? What is his reputation? What has been his past connection? Has he been connected with the borrower in the warehouse, or the storer? If so, when, and what were his duties? By whom is he now employed, and who pays him? Does he have insurance to provide indemnification for the services that he provides? Does he have a system that can provide accurate, transparent and real time reports for the benefit of the lender?

J. FACTORS THAT MAKE RECEIPTS VALUABLE

The collateral value of warehouse receipts depends upon several factors, the principal of which are:

(1) Suitability of the warehouse or storage facility for storing the product;
(2) Responsibility of the warehouseman;
(3) Competency of the warehouseman and his assistants to properly care for the product while in storage;
(4) Authority of law under which the receipt is issued;
(5) Information on the warehouse receipt itself which will give to the lender a concise yet comprehensive description of the product and thereby enable him to form an opinion of its fair market value;
(6) Terms of the warehouse receipt in general;
(7) Whether there is bonded responsibility on the back of the receipt, and, if so, by whom the bond is written, for the benefit of whom, with whom the bond is lodged, under what conditions it may be realized upon by the holder of the receipt, and what action such receipt-holder must take to realize upon the bond;
(8) Whether the receipt represents a bona fide relationship of bailor and bailee between the storer / owner and the warehouseman and one under which the warehouseman and his representatives or his local custodians are completely and wholly independent of the storer / owner.
(9) The character and extent of disinterested supervision exercised over the warehouse.

K. INFORMATION ON WAREHOUSE RECEIPT – CRITICAL

Since the warehouse receipt represents the product stored in the warehouse it should contain such information as will convey to anyone to whom the receipt is offered for collateral purposes a **fair, honest, and impartial description of the products themselves** so as to enable one to form an opinion of the fair value of the product, and to identify it. This becomes all the more important when the borrower seeks credit at some distance from the warehouse.

In commodity financing, the primary concern of the lender is the commodity that is proposed as security. In the opinion of some lenders certain commodities are bankable collateral. To other lenders the same commodities may not constitute bankable collateral. Hence, when a loan is desired on products or commodities in storage, it is important that the warehouse receipts covering such commodities clearly state what the commodities in fact are which the receipt represents.

Obviously, **a receipt that conveys no information as to the quantity, weight, quality (grade), or condition of the product, or which fails to state what the product actually is, <u>does not</u> inform the lender on points that are essential to making a fair assessment of the collateral against which a loan is being extended.** It does not enable the lender to determine whether the product is even a proper subject for collateral. **Receipts that recite that the warehouseman received a certain number of cases or bales or packages "said to contain"** canned tomatoes or wool or fancy cigar-leaf tobacco, **without any further independent assessment on quality, quantity or weight, give neither the borrower nor the lender an index as to the value of the product represented by the receipt**.

And receipts which merely acknowledge that the warehouseman has received a certain number of cases or bales or packages and then recite "contents unknown" are not only of less value, but are a clear attempt on the part of the warehouseman to escape all liability so far as the commodity is concerned.

Under either the receipts which recite "contents unknown" or "said to contain," so far as the warehouseman is concerned and his liability to deliver a specific product, the cases or packages covered by the receipts might be filled with sawdust or mere trash.

To a lender who has given no more than superficial thought to making loans on the basis of warehouse receipts as collateral, **any receipt that contains such statements as "said to contain" or "contents unknown" without any independent analysis on the quality, quantity or weight, must have no appeal whatever as a collateral certificate.**

Additionally a Warehouse Receipt must be linked to an inspection certificate of a reliable independent agency indicating quality and grade etc which certificate should be attached to the Warehouse Receipt. Any Receipt which does not indicate within it a period of validity with respect to the quality and grade calculated in light of prevailing circumstances and the storage conditions, should not be accepted by lenders. In the absence of such link, the Warehouse Receipt cannot accurately reflect the true condition of the underlying goods for an unlimited period. **Thus a renewed quality certificate is something which all lenders must urge their clients to provide after expiry of the recommended period, in order to ensure that the quality of the goods/ collateral remains intact for the entire duration of the financing.**

L. DOCUMENTATION TO REFLECT KEY LEGAL REQUIREMENTS

Warehousing on the premises of the owner proposing to pledge his merchandise is effective when done in obedience to legal requirements; but when done only far enough to get the goods represented by documents without really getting them stored, the documents are but scraps of paper.

Hence the following important principles of field warehousing as recognised by the Courts of common law jurisdictions and especially those in the US which reinforce the aforementioned points must be reflected in contract documentation:

- The general law of pledging requires possession and cannot exist without it. Delivery of possession is of the very life of the pledge. Merely colorable or constructive change of possession accomplishes nothing in favor of a pledgee. There must be open, visible, unequivocal change of possession manifested by such substantial outward signs as to make it evident to the world that the control of the owner has wholly ceased, and that another has acquired; and is openly exercising the exclusive dominion over the property.
- In order to satisfy the necessary test of possession there must be conscious control, the intent to exclude, and the actual exclusion of others, with access to the place of custody by the field warehouseman as of right.
- There is no room for make-belief, pretence or sham in field warehousing. Where there was really no delivery and no change of possession, continuous or otherwise, the alleged change will be a mere pre-tense, a sham.
- Warehouseman must evidently be a party independent of the customer and must take and maintain actual physical possession of the goods.
- Each lot of goods covered by a receipt, unless stored on a fungible basis, must be segregated from goods of others, including other goods of the owner, and the lots must be so marked as to permit identification readily on the basis of the information appearing on the warehouse receipt.

- The premises are to be leased at a nominal rental only and the lessor, in addition to paying a monthly fee, was to reimburse the warehouse company for all expenses incurred on behalf of the lender.
- A local custodian / employee of the field warehousing company sitting within the premises should not to be permitted to issue warehouse receipts or to authorize releases, but these functions should be performed at the country office of the warehouse company upon the basis of statements signed by the local representative attending the operations.
- The lender holding the warehouse receipt should be able to identify and obtain possession of the goods and thus enforce its lien without any difficulty. A lien will be of no practical value unless such property as pledged can be found and identified when it becomes necessary to enforce the lien; and, hence if custody of the goods is not maintained by a disinterested party, there is danger that the goods may be improperly released or disposed of.

CONCLUSION

It has been very well said that the term 'field warehousing' "**is not a talisman to give dominion by enchantment.**" It is taking exclusive possession and control which is the core criterion of effectively establishing a valid field warehouse evidencing open, exclusive, and unequivocal possession which has passed constructively to a pledgee.

No lender can afford to take a chance of submitting his loan collateral to a judge or jury to determine whether the facts surrounding its creation give it legality and therefore it is the duty of the field warehouseman who acts on behalf of the lender to ensure that no such circumstance arises which can place the lenders security in jeopardy.

It is a shame that despite the plethora of information, many service providers worldwide still continue to operate as mere store keepers and stock monitoring agents but incorrectly hold themselves out to be performing a credit support and collateral control function on behalf of the lending institutions.

The easiest course might be to follow the suggestion of a warehouseman, or the wishes and appeals of the borrower. But the safest course is to follow well established legal principles. A lender has a higher duty than merely to loan money. He too is a trustee of the property and interests of others. His first duty is that of a faithful servant to his trust, and he can be faithful to that trust when he lends money on field-warehouse receipts as collateral only as he makes it his business to ascertain what actual methods of operation prevail at the warehouse and how closely they square with well-established principles.

Repeatedly it has been found that borrower / depositors, in spite of representations to the contrary, were carrying keys to the warehouses, had free access to the warehouses, and operated to all intents and purposes just as freely as they did before the alleged bailor / bailee relationship was undertaken. It has found in some cases that in spite of statements to the contrary, the custodian was connected to or was an employee/ agent of the borrower. Such facts would be damaging evidence to submit to any adjudicator.

It has been our endeavour throughout this paper to set out for you certain key information regarding any field warehousing arrangement. In light of all the foregoing, what must be remembered is that eternal vigilance is the price that any lending institution must pay if it wants to feel reasonably certain of the safety of its commodity loans collateralized by field warehouse receipts which are NOT and must not be issued as mere storage receipts, but rather deemed to be financial instruments which form the backbone of the financing transaction.

If you would like more information please do not hesitate to contact the author at andre.soumah@ace-grop.net.

For a detailed review of the Table of Services offered by the ACE GLOBAL DEPOSITORY GROUP kindly contact our Group Legal Department at info@ace-group.net with the subject "Request for Table of Services".

For the forms of the different agreements used and applicable to Field Warehousing operations you may contact our in house legal team for general queries at any of the following email addresses aisha.ghazi@ace-group.net/ aileen.siayngco@ace-group.net/ anissa.mahious@ace-group.net/ info@ace-group.net for further information.