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Warehouse Receipts as Collateral

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WAREHOUSE RECEIPTS AS COLLATERAL

I. The Law Governing the Issuance and Negotiation of Warehouse Receipts.

"A WAREHOUSE receipt is a written acknowledgment by a warehouseman that he holds certain goods in store for the person to whom the writing is issued. Its validity is to be determined by the laws of the state where the property is situated at the time the receipt is issued."[1]

A warehouse receipt is a contract, delivery of which carries constructive possession and often title to the goods represented thereby.[2] The common law receipt was not negotiable but rather assignable as any other contract. The delivery of the receipt represented the delivery of the goods, and operated to vest in the assignee the same title as would be vested by an actual transfer of the goods themselves coupled with a similar agreement.[3] "At common law a valid assignment could be made without indorsement by a mere delivery of the receipt, with intent to pass title to the goods. And, statutes authorizing a transfer of warehouse receipts by indorsement have been generally construed not to prevent a valid transfer by any method previously effectual."[4]

By statutes in many states prior to the Uniform Warehouse Receipts Act, such receipts were declared "negotiable" But the word "negotiable" did not mean the same thing as in the case of promissory notes,[5] nor the same as in the case of warehouse receipts under the Uniform Warehouse Receipts Act. It was construed as meaning that

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[1] 40 Cyc. 407. The form for a warehouse receipt in the case of agricultural products stored for interstate or foreign commerce, is prescribed by the U. S. Warehouse Act as amended, Section 18. See note 11, *infra.*

[2] *Dale v. Pattison,* 234 U. S. 399, 34 Sup. Ct. 785, 58 L. ed. 1370, 52 L. R. A. (N. S.) 754 (1913).

[3] *Burton v. Curyea,* 40 Ill. 320, 89 Am. Dec. 350 (1866), *Toledo Second National Bank v. Walbridge,* 19 Oh. St. 419, 2 Am. St. Rep. 408 (1869).

[4] 40 Cyc. 416.

[5] *Anderson v. Portland Flouring Mills,* 37 Ore. 483, 60 Pac. 839, 82 Am. St. Rep. 771, 50 A. L. R. 235 (1901), cf. Bal. Code §§ 3598-3599; *Yarwood v. Happy,* 18 Wash. 246, 51 Pac. 461 (1898).

the law regards their transfer in the channels of commerce as the transfer of the goods stored.[6] They conferred the right on the transferee to bring suit in his own name,[7] and to transfer to a *bona fide* purchaser title free from any equities not apparent on the face of the instrument or otherwise known.[8] But they did not transfer better title than the original bailor had.[9] "Statutes relating to promissory notes, bills of exchange and other negotiable instruments are not to be applied to warehouse receipts, even though the latter have been declared negotiable by indorsement and delivery "[10] The U S. Warehouse Act[11] in section 21 provides for the delivery by a warehouseman of agricultural products covered by a receipt to the holder upon demand, accompanied by an offer to surrender the receipt, *if negotiable, with such indorsements as would be necessary for the negotiation of the receipt.*

II. Use of Warehouse Receipts Under Federal Statutes Making Them Eligible as Collateral.

The War Finance Corporation Act specifically mentioned warehouse receipts as one form of collateral acceptable as security for advances made by the Corporation to banks which had discounted agricultural paper. Section 24, paragraph 2, of the Act[12] of August 24, 1921, provided that the Corporation might purchase direct from banks, notes secured by warehouse receipts or other instruments in writing conveying or securing marketable title to staple agricultural products. The time of payment of such notes might be extended up to a maximum period of three years. As the Corporation was also authorized to make loans to co-operative associations of producers, the financing by cooperatives of their farmer members was made possible through the use of warehouse receipts. This enabled the products to be carried and marketed in an orderly manner.

The Act of March 4, 1923, creating the Federal Intermediate Credit Banks also recognized the warehouse receipt as acceptable collateral for loans to co-operative associations. Section 202 of this Act[13] provides

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[6] *Merchants' Nat'l Bank v. Distilling Co.*, 196 Fed. 76 (1912).
[7] *Merchants' Bank v. Hewitt*, 3 Iowa 93, 66 Am. Dec. 49 (1856).
[8] *Selma Bank v. Lee*, 99 Ala. 493, 12 So. 572, 19 A. L. R. 705 (1893).
[9] *In re Druel*, 205 Fed. 568 (1913).
[10] 40 Cyc. 419.
[11] U. S. Comp. Stat. (1918), § 84473/4 J. J.
[12] Fed. Stat. Ann. (1921) Supp., p. 29.
[13] Fed. Stat. Ann. (1923) Supp., p. 11.

that these banks may make loans direct to any co-operative association organized under the laws of any state and composed of persons engaged in producing, or producing and marketing, staple agricultural products, or live stock, if the notes or other such obligations representing such loans, are secured by warehouse receipts, or shipping documents covering such products, or mortgages on live stock: provided, that no such loan or advance shall exceed 75 per cent of the market value of the products covered by said warehouse receipts.

The National Agricultural Credit Corporations were also empowered under Section 203 of the Act[14] to make advances on notes secured at the time of discount by warehouse receipts conveying or securing title to nonperishable and readily marketable agricultural products. A similar power was given to the Rediscount Corporations by section 207 of the Act.[15]

The foregoing Act of March 4, 1923, Title IV, also amended the Federal Reserve Act so as to provide for an extension of time of paper which might be discounted, when secured by warehouse receipts. Section 403[16] amended section 13 of the Federal Reserve Act so as to read.

> "Any Federal Reserve Bank may discount acceptances of the kind hereinafter described which have a maturity at the time of discount of not more than 90 days sight, exclusive of days of grace, and which are indorsed by at least one member bank: Provided, that such acceptances, if drawn for an agricultural purpose and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples may be discounted with a maturity at the time of discount of not more than 6 months sight exclusive of days of grace."

Section 404 also added the following to section 13 of the original Act:[17]

> "Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively any Federal Reserve Bank may, subject to regulations and limitations to be prescribed by the Federal Reserve Board, discount notes, drafts

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[14] Fed. Stat. Ann. (1923) Supp., p. 18.
[15] Fed. Stat. Ann. (1923) Supp., p. 21.
[16] Fed. Stat. Ann. (1923) Supp., p. 82.
[17] Fed. Stat. Ann. (1923) Supp., p. 82.

> and bills of exchange issued or drawn for an agricultural purpose, or based upon live stock, and having a maturity at the time of discount, exclusive of days of grace, not exceeding 9 months, and such notes, drafts and bills of exchange may be offered as collateral security for the issuance of Federal Reserve notes under the provision of section 16 of this Act: Provided, that notes, drafts and bills of exchange with maturities in excess of 6 months, shall not be eligible as a basis for the issuance of Federal reserve notes unless secured by warehouse receipts, or other such negotiable documents conveying or securing title to readily marketable staple agricultural products, or by chattel mortgage upon live stock which is being fattened for market."

Under this legislation providing additional credit facilities for the agricultural and livestock industries of the United States, the warehouse receipt is made acceptable collateral for loans made by all branches of the federal banking machinery excepting the Farm Land Banks. The member banks of the Federal Reserve System by means of the rediscount facilities provided, are now in a better position to accommodate their farmer customers. The warehouse receipt itself, being made acceptable collateral for notes constituting the security for issues of federal reserve notes, is elevated into a position of prime importance as commercial paper.

III. Financing of Customers by Warehouse Companies.

In a paper on "Warehouse Loans and Credits" by Ralph C. Stohell, read at the 32nd annual meeting of the American Warehousemen's Association, it was pointed out that warehouses had undertaken the financing of their customers through loans on the commodities stored. Thus the warehouses have assumed a banking function. Loans have been largely used to assist in securing business, and in many cases this was the deciding factor. The customer by borrowing from the warehouse attains some advantages not possible from the bank, for example, higher line of credit, because the bank is restricted by law as to the amount it may loan to one account. On the other hand, the warehouse is compelled to borrow from the bank, lacking sufficient capital of its own, or sell its notes in the open market through brokers. Where the warehouse borrows from the bank, it is compelled to charge the customer a higher rate of interest than it pays the bank, owing to the necessity of leaving a portion of the borrowed money on deposit. There is a difference of opinion as to the legality of warehouse companies issuing their own notes.

IV Decisions of State and Federal Courts Construing Warehouse Receipt Acts.

The warehouse receipt has been the subject of numerous decisions of state and federal courts, and its nature, construction, operation and negotiability have been judicially determined as the result of litigation. These decisions have also determined the rights and remedies of holders of warehouse receipts and of *bona fide* purchasers of the same.

Various states have from time to time passed acts regarding warehouse receipts. In 1907 the General Assembly of Illinois passed an act known as the Uniform Warehouse Receipts Act.[18] Section 2 of this act provided that such receipts need not be in any particular form, but that every such receipt should embody certain information within its written or printed terms. It was held by the Supreme Court of Illinois in the case of *Manufacturers Mercantile Co. v. The Monarch Refrigerator Co.*,[19] that these requirements were imposed for the benefit of the holder of the receipt and of the purchasers from him, and that it was not intended that a failure to observe them should render the receipt void in the hands of the holder. The Court said, "That it was for the protection of such persons that these terms were required is indicated by the provision that their omission from a negotiable receipt should render the warehouseman liable for all damages to any person injured thereby. This provision is inconsistent with the claim that the omission renders the receipt non-negotiable." The Court also construed sections 4[20] and 5[21] of the Act distinguishing between negotiable and non-negotiable receipts. "A receipt which states that the goods will be delivered to the depositor or another specified person is non-negotiable; one which states that they will be delivered to the bearer, or to the order of a person named in the receipt is negotiable."

The Public Warehouse Act of South Dakota,[22] Section 495, provides that no person issuing a receipt for the storage of grain shall be permitted to deny that the grain is the property of the person to whom the receipt is issued. The Supreme Court of South Dakota, in the case of *Street v. Farmers Elevator Co.*[23] held that under this Act the

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[18] Smith-Hurd Ill. Rev. Stat. (1923), Ch. 114, §234.
[19] 266 Ill. 584, 107 N. E. 885 (1915).
[20] Smith-Hurd Ill. Rev. Stat. (1923), §236.
[21] Smith-Hurd Ill. Rev. Stat. (1923), §237.
[22] Pol. Cod. S. D., §495.
[23] 34 S. D. 523, 149 N. W. 429 (1914).

warehouseman is estopped, as to the person named in the grain receipt, or his assignee, from questioning the ownership of the grain, though the true owner could recover the grain from the warehouseman in an action therefor, if the depositor was not the true owner.

The Supreme Court of the State of Washington, construing the Washington Uniform Warehouse Receipts Act,[24] held that a receipt, though not conforming to the definition of a negotiable receipt as prescribed by the Act, but stamped "negotiable" and so issued, was, nevertheless a negotiable receipt.[25]

Under the Texas statutes, it is necessary for the assignee of a warehouse receipt to notify the warehouseman of the transfer to himself of the receipt in order to protect his title.[26] The Supreme Court of that state has held that the assignee cannot, unless he gives such notice maintain an action against the warehouseman after the latter has, in ignorance of the assignment, delivered the goods to the party depositing them and to whom the receipt was issued.[27] This decision was on the theory that the assignment transferred the property to the assignee, but did not effect a change in the contract between the bailor and bailee—the original depositor and the warehouseman—without notice to the latter of the change in ownership. The warehouseman remains bound to deliver to the original depositor, and though the receipt specifies it must be returned on delivery of the goods, a delivery without its production, on the bailee's representation that the receipt was among his papers and would be surrendered, constituted a defense to an action for the property or its value by the assignee, of whose rights the bailee had no notice.

In Minnesota where it has been held that under the statutes[28] providing that warehouse receipts, unless the words "not negotiable" are written or stamped on the face thereof, may be transferred by indorsement, and such indorsement shall transfer the title to the property and all rights of the indorser, the indorsement of a warehouse receipt

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[24] Rem. Comp. Stat., §§3646-3787.

[25] *Kloch Produce Co. v. Diamond Storage Co.*, 94 Wash. 431, 162 Pac. 359 (1917).

[26] 1 Vern. S. Civ. Stat. (1914) (Tex.), Art. 583-584.

[27] *Stanford Compress Co. v. Farmers and Merchants National Bank*, 105 Tex. 44, 143 S. W 1142 (1914).

[28] Rev. Laws (1905), §2097.

amounts to the actual transfer and delivery of the property itself by its symbol.[29]

In Pennsylvania it has been held that mere delivery of a warehouse receipt, without indorsement, transfers title to the goods where such is the intention of the parties.[30]

V Warehouse Receipts Pledged as Collaterals

To constitute a valid pledge of a warehouse receipt as collateral, the goods must not remain in the possession or under the control of its owner.

It was held by the Circuit Court of Appeals in a case arising in New York that warehouse receipts issued by the treasurer of a corporation and delivered as collateral security for money borrowed by the corporation, covering goods of its own manufacture, which remained in its own warehouse mingled with its other goods and without any visible change of possession, indorsed by the corporation as collateral security, did not constitute a valid pledge, nor create an equitable lien as against general creditors.[31]

But the North Dakota Supreme Court, construing the laws of that state[32] held that the execution and delivery of a warehouse receipt by a public warehouseman to his creditor as security for the indebtedness upon property actually contained in his warehouse and owned by him, operates as a valid pledge *without* the necessity of an actual change of possession, and creates the creditor a bailor and the warehouseman a bailee of the property, so as to render the surety on the warehouseman's bond liable for its safe keeping.[33]

In Georgia it has been held[34] that the pledgee of warehouse receipts is under no legal obligation to notify the warehouseman of the transfer

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[29] *Ammon v. Gamble Robinson Commission Co.,* 111 Minn. 452, 127 N. W 448 (1910).

[30] *National Reading Bank of Reading v. Shearer,* 225 Pa. 470, 74 Atl. 351, 17 Ann. Cas. 664 (1909).

[31] *American Can Co. v. Erie Preserving Co.,* 171 Fed. 540, order affirmed 183 Fed. 96, 105 C. C. A. (2 Circ.) 388 (1910).

[32] Comp. Laws N. D. (1913), §§3138-3148.

[33] *State v. Robb-Lawrence Co.,* 17 N. D. 257, 115 N. W. 846, 16 L. R. A. (N. S.) 227 (1908).

[34] *Bank of Sparta v. Butts,* 4 Ga. App. 312, 61 S. E. 300 (1908).

to him of such receipts as collateral security. But in Texas in view of the decision discussed above, such notice would seem to be required.

The Supreme Court of the United States, in the case of the *Commercial National Bank of New Orleans v. Canal-Louisana Bank & Trust Co.*[35] construed the Uniform Warehouse Act of Louisana[36] as protecting the rights of a *bona fide* purchaser for value to whom warehouse receipts had been pledged as collateral. In this case a bankrupt had pledged bills of lading for cotton to a bank and later obtained the same by giving a trust receipt in order to obtain negotiable warehouse receipts in exchange for his bill of lading. Having secured the receipts he pledged them to a second bank. It was held that the first bank was precluded from questioning the title of the second bank which had purchased the receipts in good faith.

VI. The Washington Uniform Warehouse Receipts Act.

In the case of *Citizens Bank v. Willing*[37] arising under the Uniform Warehouse Receipts Act of the State of Washington,[38] the definition of a warehouseman as defined by the Code—"A person lawfully engaged in the business of storing goods for profit" was construed. Here the warehouse company had no separate building of its own, and did not store goods for the public generally or at all. It only stored the product of one company, the Red Cedar Co., in a room or shed on the premises of that same company. It was simply a device by which the bank was furnished negotiable warehouse receipts as collateral security for the loans it had made to the Red Cedar Co. The evidence failed to show that the warehouse company was storing goods for profit and therefore it was held not to come within the statutory definition. Since the bank held no title under the warehouse receipt, though negotiable in form, it was held it could not recover as owner.

In the case of *Hastings v. Lincoln Trust Co.*[39] where the receipt was issued to the owner of an automobile "or order, at our warehouse, as and when directed upon the surrender of this receipt properly endorsed,"

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[35] 239 U. S. 520, 60 L. ed. 417, 36 Sup. Ct. 194 (1915).
[36] Walff's Const. and Stat. 1920, pp. 1789-1801.
[37] 109 Wash. 464, 186 Pac. 1072 (1920).
[38] See note 24, *supra*.
[39] 115 Wash. 492, 197 Pac. 627 (1921).

it was held that the effect of the statute prevented a transfer otherwise than by indorsement, and the mere delivery of the receipt, unindorsed, was held not to constitute a delivery of possession of the goods, as against a receiver claiming right of posssesion for the benefit of creditors. The Court did not consider the question whether or not transfer by indorsement of such a warehouse receipt was, because of the statute, an *exclusive* method of transferring such a receipt and the title to the property therein described.

In *State Bank of Wilbur v. Almira Farmer's Warehouse Co.*[40] the Court held that "weigh tickets" not complying with the form prescribed in the Act or containing the necessary data, could not be considered as negotiable instruments. The question of the warehouseman's lien also arose in this case, and the contention was made that a lien could be claimed only for advances in connection with the storage of goods. But the Court found that the advances had been made in connection with the *growing* and *handling* of the grain and held that such advances clearly fell within the provisions of the Code. The Court stated that the Washington statute was much broader in this respect than that of New York and that money advanced by a warehouseman for the foregoing purposes clearly entitled him to a lien.

Likewise the liabilities of the party to whom warehouse receipts are pledged as collateral security are not those of one having full title. It has been held in Washington that the assignee takes only a qualified title to the warehouse receipt and the property it represents and is not liable for the storage charges where he did not do anything to take or assume possession or control over the stored property.[41] The Court quoted the opinion of the New York Court of Appeals,[42] where the facts were almost identical. The quotation read,

> "The right that he (the assignee) acquires is not an absolute title, for the owner may redeem, and the right of possession is subject to the liens of the warehouseman for storage. A person therefore, who becomes a holder of a warehouse receipt as collateral security, does not, by reason of his having possession of the receipt, necessarily become bound for the

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[40] 123 Wash. 354, 212 Pac. 543 (1923).

[41] *Millichamp v. First National Bank of Toppenish*, 130 Wash. 175, 226 Pac. 490 (1924).

[42] *Driggs v. Dean*, 167 N. Y. 121, 60 N. E. 336 (1901).

storage of the property. It is true he has a qualified title, and he may, if he so elects, take or reduce the property to possession upon payment of the storage. He, however, is not bound to take possession of the property, or to pay the charges thereon."

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