

PROPOSED PRINCIPLES FOR ELECTRONIC WAREHOUSE RECEIPTS

(presented by Dr. David P. Stewart)

An earlier paper on this topic described in general the potential benefits of adopting a system of electronically-issued warehouse receipts (“EWR”) allowing farmers to store some of their commodities after harvest and to use the receipt as collateral for loans based on the market value of their commodities. That paper proposed the preparation of a possible model law encouraging the development of an effective system of electronic warehouse receipts in the hemisphere. This paper outlines the basis for a set of draft principles for consideration in the formulation of a possible OAS Model Law on the subject of electronic warehouse receipts.

Background

As indicated in the earlier paper, a warehouse receipt serves as a document of title and provides proof of ownership of a specific quantity of products with specific characteristics and stored in a specific location, such as warehouse. A *negotiable* warehouse receipt is more than proof of ownership; it also gives the holder the right to transfer ownership while the goods are still in the possession of the warehouse. It can also serve as collateral, and can be sold, traded or used for delivery against financial instruments including futures contracts.

Warehouse receipt financing is a form of asset-based lending that allows farmers to obtain bank loans by pledging warehouse receipts issued to them against commodities deposited in warehouses. Warehouse receipts are issued by accredited warehouses to the farmer; the receipt acknowledges the quantity and quality of the produce deposited with the warehouse and typically contains the terms of the storage contract between the farmer and the warehouse. On the basis of these receipts, the farmer can raise money from banks willing to accept the receipts as collateral.

A modern *electronically-based* system of warehouse receipts can significantly increase the speed of transactions without increasing the risk, thereby permitting small producers (especially those who produce perishable commodities) to participate in markets much farther from their own locations.

General Conditions

An effective warehouse receipts system can reduce uncertainty and increase efficiency in agricultural markets. But its success depends on several conditions. Clearly, a surplus of the relevant commodities must exist; otherwise, the producer will have no products to sell. There must be accessible markets; otherwise, the producer will have no place to sell the products. The necessary commercial infrastructure (warehouses and an effective transportation system) must exist to connect the producer to those markets.

Of course, a strong warehouse receipt system needs to be tied to effective financing mechanisms. Banks must be prepared to offer the necessary financing. This, in turn, requires a reliable legal structure regulating the system of warehouse receipts and guaranteeing the enforceability of the receipts in case of default. Besides mandating the negotiability of warehouse receipts, the system must also prescribe the form and manner of registration of warehouses and issue of negotiable warehouse receipts, including the legitimacy of electronic records and transfers.

The system must also provide effective government monitoring and oversight. Warehouses must be inspected and licensed (by governmental agencies or non-governmental bodies such as trade groups) according to established standards, and some form of regulatory authority is needed to protect the interests of holders of warehouse receipts against negligence, malpractices and fraud.

Specific Considerations

Scope of Application

In the first instance, the proposed principles should focus on the market in agricultural products generally (although they might eventually be expanded to cover other commercial sectors). For the moment, it is not suggested to include fisheries or forest products, or to make the principles “commodity specific” (for example, by addressing cotton or flowers).

OAS Model Law on Secured Transactions

The principles (and the Model Law) must be consistent with the 2002 OAS Model Law on Secured Financing (which has been adopted in Guatemala and Honduras, partly implemented in Mexico and Peru, and is under consideration in Colombia and Costa Rica) as well as its Model Registry Regulations. They must also take account of the 2001 Uniform Inter-American Rules for Electronic Documents and Signatures.

Paper vs. Electronic Receipts

Some countries in the hemisphere have not yet enacted the necessary legal provisions to recognize electronically transferrable records. As a consequence, the principles (and any subsequent Model Law) should accommodate both paper-based and electronically-based records and take account of the problems of making the transition from one to the other.

Other International Efforts

The principles should take account of the continuing work on electronically-transferrable records in other international fora. In particular, UNCITRAL’s Working Group IV is continuing to study electronically transferrable records and has given emphasis to principles of non-discrimination, technological neutrality and functional equivalence (writing and signature). See, e.g., the Report of the Working Group on its forty-seventh session (New York, 13-17 May 2013), UN doc. A/CN.9/768. In the past several years, the FAO has also undertaken a review of the legal frameworks for warehouse receipt financing worldwide, and UNIDROIT is currently considering the preparation of a Legal Guide on Contract Farming as “an inclusive model of investment” that should be consistent with the Principles for Responsible Agricultural Investment.

Cross-Border Coordination

The principles should take into account existing mechanisms of warehouse receipts at the domestic level. For the system to work well on a regional basis, the principles should provide for cross-border coordination and “connectivity” in the recognition of transactions.

Nature and Contents of the EWR

In the most basic sense, the warehouse receipt operates as a receipt for storage of identified goods. More broadly, it should be a standardized contractual agreement between the initial owner of the goods (the “bailor”) and the warehouse operator (the “bailee”) providing for storage of a specific quantity of goods with specific characteristics in a specific warehouse goods for a specified period.

The receipt should therefore set forth the respective rights and obligations of the owner/depositor and the warehouse operator, obligating the latter to store the goods in certain conditions and to release the goods or to transfer their ownership upon demand by the owner or receipt holder upon certain conditions.

It should also be valid both as a statement of ownership rights (functionally equivalent to a document of title) and as a statement of security interests -- in other words, combining the functions of a certificate of deposit or title and a pledge bond.

It should be valid both in paper and electronic form -- in other words, an EWR should be the “functional equivalent” of a paper form.

The principles should cover both negotiable and non-negotiable EWR’s. The receipt itself must state whether or not it is negotiable. A negotiable warehouse receipt is one providing that the goods are deliverable either to the person named in the receipt or to the bearer.

The Warehouse

The warehouse operator should be required to keep appropriate records of the relevant transactions. The operator must be commercially responsible and must exercise a general duty of care as a “bailee” or custodian.

Warehouses should be accredited and licensed to store goods by an appropriate, independent governmental or trade authority. The accreditation and license should be for a stated period of time, renewable under certain conditions. The appropriate governmental or trade authority should have continuing responsibilities of supervision, inspection and regulation, with rights of access to monitor the warehouse operation.

The warehouse must be insured against loss of and damage to products in its custody. The operator may be required to post a performance bond.

Rights of Parties to the EWR

Holders of receipts must have the right to receive stored goods or their fungible equivalent if the warehouse defaults or its business is liquidated. The principles should explicitly recognize a *pro-rata* interest in commingled, undifferentiated stored commodities.

When the EWR is negotiable, the rights, duties and liabilities of each party to the receipt (producer, warehouse, transferees such as a bank, etc.) must be clearly defined. Ideally, receipts should be freely transferable by delivery and endorsement.

The principles must address the issue of security interests. For example, the warehouse operator who stores the goods typically charges for the cost of storage (and possibly other

services such as cleaning) and should therefore be entitled to a possessory lien against the goods in order to secure payment. The operator is also entitled to protection against fraud.

The goods may be encumbered with pre-existing claims when deposited or may become encumbered with subsequent claims. For example, the lender may be exposed if the warehouse operator exercises a lien for storage costs, if a *bona fide* buyer acquires the goods from the warehouse operator, or if the goods are subject to attachment by other instruments. Before granting the loan on the basis of a negotiable EWR, lenders should be able to determine if there is a competing claim.

Priorities may be created by law, such as claims for taxes or employee salaries, or pursuant to an intervening bankruptcy. The principles should require clear procedures in case of bankruptcy of the warehouse operator and for the administration of financial performance guarantees.

The “holder” (the original depositor, a lender, or buyer) is entitled to receive the goods in exchange for the receipt or to appropriate payment in lieu of the goods, as well as protection (priority) in the event of fraud in the issuance of the receipt or bankruptcy of the warehouse operator.

The holder of the receipt may be required to “perfect” its security interest or to take additional steps to establish priority over claims by third parties.