THE ESSENCE OF FIELD WAREHOUSE receipt financing is the issuance of warehouse receipts to the depositor, who pledges them to the creditor as collateral security for a loan. Among the principal factors considered by the creditor in evaluating such receipts are the reputation of the warehouseman and the technical conditions under which the field warehouse is installed and operated. Attention is therefore directed to the bearing of these conditions upon the legal position of the field warehouseman and his relations to depositor and banker.

Legal Position of the Field Warehouseman

In establishing a field warehouse, the company acts under the statutes governing public warehouses and public warehouse receipts in the state wherein the warehouse is established. Every state licenses public warehouses, prescribes certain requirements that warehousemen must meet, and specifies the liabilities that they must assume toward depositors. Every state, except New Hampshire and South Carolina, has adopted the Uniform Warehouse Receipts Act in substance. Under these statutes no distinction is drawn between field warehouses and other types of public warehouses. The liabilities of the warehouseman and the nature of warehouse receipts issued by him are the same, whether the warehouse is a field warehouse or a terminal warehouse.

At law, the warehouseman is the bailee of merchandise. The key to the establishment of a field warehouse is the creation of an effective bailment of the commodities deposited with the warehouseman. In general, it may be said that an effective bailment exists when the warehouseman has "continuous, exclusive and notorious" possession of the goods. These conditions must be fulfilled because the warehouse receipt issued by a warehouseman
is a document conveying title in the goods specified on its face to the holder of the receipt. The possessor of a warehouse receipt is prima facie the owner of the merchandise; acknowledgment by the transferor or recordation of the receipt is not necessary, as in the case of a chattel mortgage. Clearly, the establishment of an effective bailment presents a greater variety of problems when a special warehouse is set up on the premises of the depositor than when the merchandise is brought to a pre-established terminal warehouse.

Methods of Establishing Field Warehouses

In acquiring continuous, exclusive and notorious possession of the commodities received by him from a depositor, a warehouseman normally takes the following steps.

The initial step is for the warehouseman to enter into a lease agreement with the depositor, under which the depositor leases a portion of his property to the warehouseman for a rental payment, usually nominal in amount. The leased premises may comprise a warehouse or part thereof, a yard, dock, pool of water, or other suitable space in which the particular merchandise being deposited may be held separately.

Next, the warehouseman complies with the requirements of the law of the state wherein the warehouse is located, and, where this is required, obtains a license to operate as a public warehouseman in that state.

Upon taking over the leased premises as tenant, the field warehouseman establishes such physical conditions that only he or his employees may have access to these premises. This is done in order to acquire exclusive and continuous possession of the commodities. The method of accomplishing this necessarily varies with the nature of the commodities and the premises in which they are stored. If the premises consist of a closed building, the warehouseman must equip the building with locks, the keys to which are held only by himself or his employees, so as to preclude access by any other person. If the premises consist of a yard or dock, the warehouseman must construct a fence or other barrier such as will make the goods inaccessible to other persons. In cases where it is impossible by such methods to prevent the depositor from gaining access to the stored commodities (for example, log
boom stores in a river or pond), the warehouseman may establish “exclusive possession” of the goods by maintaining continuous custodianship service.

The warehouseman’s possession of the deposited merchandise must also be “notorious.” This requirement is usually fulfilled by posting an adequate number of signs in conspicuous places within and without the field warehouse. These signs put other persons, including creditors of the depositor, on notice that the merchandise in the warehouse is held by the warehouseman whose name is specified on the notices, and is the property of the person holding the warehouse receipts.

The next step is for the warehouseman to place one or more of his employees in charge of the warehouse, and to arrange that they alone have access to the merchandise contained therein. These officials are variously described as “custodians,” “storekeepers,” “warehouse managers,” “bonded representatives” or by other terms. Herein they are called custodians, for convenience. Custodians receive deposits, issue warehouse receipts or certify that receipts may be issued, and deliver merchandise out of the warehouse upon surrender of warehouse receipts or orders of release executed by the properly accredited receipt holders. The majority of field warehousing companies do not permit their custodians to issue receipts. Under a typical procedure, commodities brought to the warehouse for deposit are checked in by the custodian or assistant custodian, and are listed on a receiving record. This record is signed by the custodian and assistant custodian to certify that the goods as described have actually been received in the warehouse. It is also signed by the depositor, who certifies that these goods have been deposited, that the values stated on the receiving record are correct, that the goods are to be stored in the name and for the account of a specified financing agency, and that a particular type of warehouse receipt is to be issued to that agency. Two copies of the receiving record are forwarded to the nearest office of the warehousing company for checking. Warehouse receipts covering the goods described in the record are then signed by an authorized representative of the warehousing company and sent to the financing agency.

Since the position of custodian is one of considerable trust and responsibility, the qualifications of the person holding this office
are important, both at law and in fact. These qualifications are discussed at a later point.

Forms of receipts differ as between warehousing companies and also as between the types of commodities contained in the warehouse. In the first place, receipts may be negotiable or non-negotiable in form. Negotiable warehouse receipts are usually issued in cases where a negotiable instrument is desired by the financing agency or where the commodities deposited in a field warehouse are of such nature that all withdrawals are made in units, and not in fractions of a unit.\(^1\) Non-negotiable receipts are generally used in cases where the financing agency does not wish a negotiable instrument or where it is desired to withdraw at different times fractions of a unit itemized on a given warehouse receipt. Such fractional withdrawals can be made on a release signed by the receipt holder, without physical surrender of a non-negotiable receipt. In the case of a negotiable receipt, the warehouseman is legally bound to require physical surrender of the receipt before releasing any part of the merchandise covered by it. It appears that the great majority of receipts issued in respect of goods stored in field warehouses are of the non-negotiable type, both for reasons of convenience and because of a belief by some bankers that a non-negotiable receipt issued in the name of a bank evidences an actual physical transfer of the commodity to the bank, whereas the negotiable receipt issued in the name of a depositor and transferred to a bank by endorsement evidences merely a symbolic transfer. Typically, receipts are issued by the warehouseman to the financing agency and not to the depositor, as noted above.

Apart from the matter of negotiability, warehouse receipts may differ with respect to their content. The Uniform Warehouse Receipts Act requires that each receipt shall specify the following: the location of the warehouse; the date of issuance of the receipt; the consecutive number of the receipt; whether the commodities are deliverable to bearer, to a specified person, or to a specified person or his order; the rate of storage; the nature of ownership of the commodities by the warehouseman, if any; the advances made or liabilities incurred for which the warehouseman claims

\(^1\) To illustrate, a warehouse receipt may be issued upon the deposit of, say, 10,000 square feet of lumber in a field warehouse. This is a "unit" for purposes of that receipt, but the depositor may wish to withdraw it in lots of 1,000 square feet on ten successive occasions.
a lien on the commodities; signature of the warehouseman; a "description of the commodities or of the packages containing them." In regard to the last-named requirement, it is the prevailing practice of warehousemen to issue receipts stating that so many boxes, bales, cartons were received "contents unknown" or "said to contain" certain commodities.

In short, the warehouse receipt usually gives merely a general description of the merchandise, and makes no representation concerning the quantity, quality, grade or condition of products unless this is readily ascertainable on sight. (All warehouse receipts must, however, describe the goods with sufficient definiteness so that they are readily recognizable.) Upon the request of receipt holders, some field warehousing companies, however, will have their own experts examine the contents of packages received, and grade the commodities contained therein. Often, and always in the case of packaged merchandise, this is done by sampling.2 Warehouse receipts in such cases specifically state the quantity, quality, grade and condition of the product. It is clear that this may be an ancillary service of considerable importance to the financing agency, for if the warehouseman does not undertake to perform such service, the banker may have to procure these services from another source or perform them himself. The value of such service is in most cases less to lenders against receipts covering goods stored in field warehouses than to lenders on the security of receipts issued by public terminal warehouses. The nature of the bulk of merchandise received into field warehouses can be ascertained on sight, whereas commodities coming into terminal warehouses are for the most part received in closed bales, barrels, cases, cartons or other containers.

The Uniform Warehouse Receipts Act provides for the issuance of warehouse receipts covering fungible goods, if authorized by special agreement between warehouseman, depositor and a bank, or where such practice is customary in the trade. These are commodities, such as pieces of lumber or steel or tons of coal, any unit of which, from its nature or by mercantile custom, may be treated as the equivalent of any other unit. Warehouse receipts

2 In some trades an accredited sampling method is recognized by custom. For commodities traded on organized exchanges, such as wheat, rice or corn, the method of sampling may be specified by the exchange. The United States Department of Agriculture also prescribes certain sampling methods.
covering fungible commodities merely specify the quantity and grade or specifications of the deposits covered by them. They permit the warehouseman to deliver any units of that grade or quality, and not necessarily the identical units that were deposited at the time a warehouse receipt was issued.

In warehousing miscellaneous merchandise that has a relatively high rate of turnover (inventories of wholesale grocers are an excellent example), the agreement of bailment provides a variation from the practices described previously. Such agreements make it possible to dispense with most or all of the burdensome task of issuing and cancelling numerous warehouse receipts that would otherwise be performed under the ordinary procedure. Briefly, an agreement of bailment is entered into between the borrowing business, the lending bank, and the field warehousing company. This agreement provides that all commodities within the specified field warehouse will be received and held for the account of the bank. When the warehouse is first installed, the lender obtains a complete physical inventory of the goods deposited in it, and an evaluation of these goods at cost plus freight in or at market, whichever is lower. The warehouseman may then issue to the bank a single warehouse receipt covering and describing the deposit, although it appears that this is not always done. In any case the lender then advances certain funds to the borrower against the deposited collateral security.

As new merchandise is deposited and old merchandise withdrawn from the warehouse, the warehouseman renders to the lender a daily or a weekly statement showing the net changes in the amount and value of collateral, and may issue a new warehouse receipt covering the net addition or reduction. Alternatively, he may by agreement reissue the original receipt in the properly adjusted amount. New advances are made by the bank, or repayments required, based upon these changes. The warehouseman is usually given a blanket release authorization by the bank, empowering him to release a specified maximum quantity or value of goods per day, per week, or per month. This is desirable in order to give the warehouseman power to satisfy the needs of the borrower for some flexibility in conducting his business. Periodically, a complete physical inventory is made either directly by the lender or by the warehouseman—at the request of the lender—in order
to check the actual quantities of merchandise in the warehouse with those calculated to be present.

This system has the advantage of greatly reducing the administrative costs of field warehouse lending, and of making it possible for the borrower to negotiate lower loan rates than would otherwise be required. The system is also said to possess the advantage to the lender of rendering all commodities in the warehouse exempt from attachment or execution by creditors. However, in order to overcome any question of preference in the event of bankruptcy, it is necessary for the warehouseman to maintain accurate records of the quantity or quality of goods deposited in or taken from the warehouse, and of the dates of receipt or delivery. It is also necessary that inventories be taken frequently by the warehouseman, and that such inventories be based upon actual counts made within the warehouse and not upon estimates. All of the necessary conditions of a valid bailment, including "continuous, exclusive and notorious" possession of the goods by the warehouseman must, of course, also be fulfilled in warehousing under an agreement of bailment.

The agreement of bailment is a relatively new departure in field warehousing and has been viewed with disapproval by many banks and field warehousing companies, which maintain that the identity of goods is lost under the arrangement. Although the courts have not spoken with finality on the basic validity of the agreement it is a device that cannot be ignored in a description of contemporary field warehousing.

The Warehouseman's Bond

Operators of field warehouses assume responsibilities to their depositors and to the holders of their warehouse receipts. The most important of these obligations is to deliver goods to the accredited receipt holder upon surrender of the receipts, and to indemnify owners for "any loss or injury to the goods caused by his (the warehouseman's) failure to exercise such care in regard to them as a reasonably careful owner of similar goods would exercise." Although the warehouseman is not responsible for such

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8 See Wesley J. Schneider, *Field Warehousing* (New York, 1941) pp. 11-12.

* See *First National Bank of Portland vs. Lakeview Pine Lumber Co.*, Circuit Court of Oregon for Lake County, Equity No. 3459 (September 12, 1939).
normal deterioration in the value of commodities in his custody as results from the passage of time, he is responsible for providing and maintaining storage facilities that are adequate when judged by warehousing practices customary in the trade.

With few exceptions, field warehousing companies provide the holders of their receipts with legal liability bonds, indemnifying the holders against loss arising from failure of the warehouseman to discharge his duties under the warehousing laws of the state governing his operations. Warehouseman's liability policies are written by several American bonding and insurance companies and by London Lloyd's. Since the value of merchandise in the custody of a field warehousing company at any given time is normally many times as large as the net worth of the company, the depositor or receipt holder necessarily must rely upon such insurance for protection against fraud or incompetence. The amount and coverage of warehouseman's liability insurance are therefore important factors in appraising the worth of warehouse receipts as collateral security for loans. It is important to observe that warehouseman's bonds do not insure the receipt holder against loss by fire, water damage, or other causes arising outside of the warehouse, unless the loss occurred by reason of the negligence of the warehouseman. Such risks must be specially provided for by the depositor or the financing agency.

**Qualifications of the Custodian**

The prevailing practice of field warehousing companies is to employ as custodian of a field warehouse a person formerly employed by the depositor, rather than bring in an "outsider" to operate the warehouse. Some field warehousmen follow a policy of paying a full-time salary to the custodian, even though the operation of the warehouse may require only part-time service, leaving the custodian free to devote some of his time to work for the depositor. Other companies employ and compensate the cus-

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6 To illustrate, the warehouseman's bond would cover losses resulting from a fire originating in some building adjacent to a field warehouse, if the warehouseman had negligently permitted inflammable debris to be scattered about the floor of the warehouse, and sparks from the fire had come through open windows into the warehouse and ignited this debris.

6 Some warehouse companies issue "insured" warehouse receipts upon request, which set forth the value of the commodities stored and cover a wide variety of risks.
todian on a part-time basis, permitting the custodian to remain on the payroll of, and to perform duties assigned by, the depositor during the remainder of his time.

Cost is the consideration determining this practice. Clearly, it is less expensive for the field warehouseman to utilize the services of a person who is already familiar with the business operations and warehousing routines of the depositor than to bring in and train new personnel. In practice, the installation of the field warehouse may involve little or no alteration in the duties of the custodian—merely a change of employer. If the custodian formerly worked only part-time on warehousing duties, he may continue to work part-time for the warehousing company, and also continue to perform regular part-time duties for the depositor. In this case, all that is involved from the point of view of the depositor-borrower is a shifting of an employee from direct payroll to indirect cost of obtaining credit. The salary paid this employee by the warehousing company becomes an item of cost in the operation of the warehouse, and ultimately becomes a part of the borrower’s cost of obtaining credit on the security of field warehouse receipts. These costs of obtaining credit would in most cases be much larger if the warehousing company hired special “outside” personnel to run the warehouse, and especially so if the warehousing company paid a custodian for full-time service when only part of his time was required for custodianship. Under the latter arrangement the market for field warehouse receipt financing would be considerably curtailed.

It is uniform practice for warehousemen to procure a bond for each custodian, indemnifying the warehousing company against loss from infidelity, fraud or theft on the part of the custodian. The cost of such bonds is, of course, included in the charge made by the warehousing company to the depositor.

The Administrator of the United States Warehouse Act has strongly and consistently criticized the practices of field warehousing companies in employing custodians. He has refused to license warehouses following these practices under the United States Warehouse Act, thus preventing them from issuing Federal warehouse receipts. The basis of his criticism is that there must be an absolute transfer of possession of the commodities deposited in the warehouse in order for the bailment to be effec-
tive, and there is no such absolute change of possession when the custodian or assistant custodian of a warehouse is a former employee of the depositor and normally expects to be reemployed by the depositor at the termination of the field warehouse arrangement. Such custodians cannot be "disinterested" and have complete allegiance to the warehousing company. It is conceded by the Federal authorities that the hiring of full-time custodians who have no former connection, business or otherwise, with the depositor would greatly increase the cost of operating field warehouses. But it is urged that these costs are necessary and unavoidable in order to create "good" bankable collateral.

It may be observed that the Board of Governors of the Federal Reserve System has by implication concurred with the view of the Administrator. The Board has ruled that bankers' acceptances, when secured at time of acceptance by warehouse receipts issued by public warehousemen employing former or part-time employees of the depositor as custodian, are not eligible for rediscount at Federal Reserve Banks. Since commercial bankers have seldom needed to rediscount bankers' acceptances so secured during recent years, this opinion has not, in all probability, precluded any banks from making loans secured by field warehouse receipts.

The field warehouse companies argue that the views of the Administrator of the United States Warehouse Act regarding custodianship are not valid, because the holder of field warehouse receipts can look to an independent warehousing company for responsibility in conducting the warehouse. Therefore, they urge, it is immaterial whether or not the responsible warehouseman brings a former employee of the depositor into the situation as custodian of the warehouse. They point out further that the United States Warehousing Act was passed in order to make it possible for storers of agricultural products to operate their own warehouses, and this Act does not require that the operator of a warehouse licensed under it shall be a bona fide public warehouseman. Under these conditions there is reason for insisting that the custodian shall not be a former employee of the depositor,

7 See H. S. Yohe, "Field Warehouse Receipts—Collateral or No Collateral," Agricultural Marketing Service (United States Department of Agriculture, March 1941) p. 4.
8 See Federal Reserve Bulletin (June 1937) p. 518.
because no independent warehousing company is a party to the arrangement.

Whatever merits these opposing contentions may have, it remains true that Federal and state courts have upheld the validity of warehouse receipts issued by warehousemen utilizing former employees of the depositor as custodians, provided that the bailments were effective in all respects as a result of good warehouse management. It should be remembered that field warehousemen operate under the Uniform Warehouse Receipts Act and store commodities of different types than those customarily deposited in warehouses licensed under the United States Warehouse Act.

The major problems of the field warehouseman center upon the maintenance of the proper physical conditions of storage of the merchandise deposited with him, and upon the selection and supervision of custodians. Intimate knowledge is necessary regarding the physical attributes of the warehoused commodity, the hazards of deterioration to which it is subject, and the normal practices of the industry for minimizing loss resulting from deterioration of quality or effectiveness of merchandise through time. Illustrative of the scope of such problems are the regulations promulgated by the Secretary of Agriculture under the United States Warehouse Act of August 11, 1916, as amended. A separate booklet of regulations has been issued for each of the following commodities: cotton seed, cotton, grain, cherries in sulphur dioxide brine, nuts, broom corn, dry beans, dried fruit, cold-packed fruit, and seeds. Regulations pertaining to each of these comparatively few commodities run to twenty or more closely printed pages. The larger the number of commodities for which he becomes custodian, the broader and more precise must be the technical knowledge of the field warehouseman. In practice, all of the larger field warehousing companies install warehouses for a variety of commodities. None specializes in the products of one industry.

The records of field warehouse companies reveal that field warehousing arrangements between particular depositors and custodians are usually not of long duration, excepting in industries such as canning wherein there are characteristically large seasonal fluctuations in working capital needs. Warehouses have
Field Warehouse Financing

been in continuous existence for as long as 15 years, but the average life of a field warehouse appears to lie between 3 and 5 years. The short-lived warehouses are established not for firms having wide seasonal variations in working capital requirements but for firms that are in process of "working out" of a straitened financial position or are experiencing secular expansion in business volume. In the latter cases, use of the field warehousing device enables such business concerns to tide over the period within which they accumulate additional equity and working capital, and subsequently to become able to borrow their requirements on an unsecured basis. Unfortunately, want of data precludes a more precise statement of the time-pattern of field warehousing as a business financing device.