

December 4, 2019

The English Commercial Court has delivered a judgment¹ in a commodity repo dispute that has implications for commodity financiers and others using warehouse receipts.

The case is a reminder that:

- except in a small number of specific jurisdictions or markets, a warehouse receipt is neither a negotiable instrument nor a document of title to goods. Accordingly, being given possession of a warehouse receipt (with or without it being endorsed in favour of the person to whom it is given) does not usually transfer title to the goods to which it refers;
- in many jurisdictions, to take a pledge of goods that creates an effective security interest, it is often necessary to have actual or constructive possession of the pledged goods. To have constructive possession, it is often necessary (as a minimum) for a third party with actual possession of the goods (such as a warehouse keeper) to "attorn" to the pledgee. This is done by the actual possessor agreeing directly with the pledgee to possess and hold the pledged goods for and to the order of the pledgee and to the exclusion of everyone else;
- being given physical possession of a warehouse receipt originally issued by a warehouse keeper to another entity (with or without its being endorsed to the person to whom it is given) will not usually give constructive possession of the goods mentioned in the warehouse receipt or otherwise act as an adequate substitute for attornment; and
- where two innocent parties contract with regard to certain goods and have been misled by a third party fraudster as to the ownership, nature or existence of those goods, an arcane doctrine of English contract law known as common mistake may determine which of the two innocent parties will bear the loss caused by the third party's fraud. It is possible for an innocent contract party in this situation, such as a commodity financier in a repo transaction, to protect itself from losing out via the doctrine of common mistake by express drafting. This is something which Natixis succeeded in doing in this case and underlines the wisdom of working with rigorously drafted template documents when entering into commodity repos.

Simplified facts

Natixis entered into certain commodities repos with Marex in respect of batches of nickel. The nickel was stored in warehouses owned and operated by Access World.

In line with the repo agreements, Marex submitted to Natixis warehouse receipts for all nickel it had sold to Natixis. These receipts had been issued by Access World to a third party. It later emerged that all of these warehouse receipts were forgeries.

Upon realising the forged nature of the warehouse receipts, Natixis closed out its futures positions in respect of the

nickel, and successfully claimed US\$32 million in damages from Marex. Marex, in consequence, brought claims against Access World.

Disputes between Natixis and Marex

The court found that, in delivering the counterfeit warehouse receipts to Natixis, Marex had breached fundamental terms of the repo agreements. Their breaches included Marex selling nickel to Natixis that Marex did not own and, consequently, failing to pass title to the nickel to Natixis.

Another alleged breach was that Marex failed to supply Natixis with "Required Documentation" under the repo agreements when it passed on to Natixis the forged warehouse receipts it had received from Access World. On this issue, Marex argued that:

- its only obligation was to provide Natixis with whatever warehouse receipts it had received; and
- it was protected by the doctrine of common mistake, which meant that the losses caused by the fraudulent warehouse receipts fell on Natixis.

Dismissing both of Marex's above arguments, the court found that Marex's obligation was to provide "objectively genuine warehouse receipts" (and that not to do so would be "contrary to the natural meaning of the clauses"). This finding effectively placed the risk of the innocent parties' mistake caused by the third party's fraud on Marex. This was because only where a contract is silent as to the attribution of risk for mistake may a successful argument for common mistake to be invoked.

Warehouse receipts

In ruling on the disputes between Marex and Access World, the court considered the nature of warehouse receipts and stated that:

- under English law, warehouse receipts are not documents of title;
- no contractual relationship arises between a warehouse operator and an endorsee of a warehouse receipt unless the warehouse operator agrees it is holding the relevant goods on behalf of the endorsee; and
- the relationship between a warehouse keeper and the person who has the right to possess the goods in the former's possession is that of bailment (i.e. a transfer of possession and not of ownership).

1. [2019] EWHC 2549 (Comm)↔

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