

CLIENT GUIDE TO TRADE FINANCE DISPUTES: WAREHOUSE RECEIPT FRAUD

Warehouse receipt fraud and the practice of financing the same goods more than once remains a serious and recurring risk in commodity markets. When fraudulent receipts are used to support multiple lending facilities, losses can be substantial and recovery prospects difficult.

This guide outlines what warehouse receipt fraud is and how it arises; highlights the key related legal issues and how disputes commonly arise; and looks at some example cases from the English Courts. It also provides hints and tips on how to spot fraud, how English law can assist victims of fraud and how to reduce exposure to fraud.

What are warehouse receipt frauds and how do they arise?

A single piece of paper can unlock tens, or even hundreds, of millions of dollars in financing. A warehouse receipt is exactly that kind of paper: a document issued by a storage operator, confirming that specific goods are held at a named facility. In commodity finance, it is often the only tangible link between a lender's money and the physical metal, grain or oil sitting behind it. Lenders and traders rely on it as evidence of the existence and location of their collateral and when the receipt is genuine, it provides a reliable basis for credit decisions. The trouble starts when it is not: a falsified or duplicated receipt converts that same piece of paper into an instrument of fraud, capable of exposing one lender, or several at once, to losses from assets that either do not exist or have already been pledged elsewhere.

Under English law, warehouse receipts are not documents of title; the relationship between the holder of goods and the person who has the right to possession of those goods is one of bailment. The relationship created by the warehouse operator and the original depositor of the goods is one of contractual bailment and is evidenced by the terms of the warehouse receipt. There is no relationship between the warehouse operator and the endorsee of a warehouse receipt unless and until the warehouse operator acknowledges to the endorsee that he holds the goods on his behalf – in other words there is an "attornment" from the warehouse operator to the buyer of goods in storage – as required by s.29 of the Sale of Goods Act 1979.

Warehouse receipt fraud is, unfortunately, topical: there have been a number of high-profile such frauds in recent years and there are several high-value claims involving fraudulent or duplicated commodity financing documentation currently proceeding through the English High Court, underlining that this is a live risk rather than a historic one.

Duplicate and fraudulent receipts

The most straightforward form of warehouse receipt fraud involves the creation of forged receipts that purport to evidence commodities stored at a facility. A borrower presents these documents to one or more lenders to obtain financing against goods that either do not exist or are substantially less valuable than represented.

A related variant is the duplication of genuine receipts. A borrower holds a legitimate receipt for goods actually in storage and uses that receipt as the basis for financing from multiple lenders simultaneously. Each lender believes it has a first-ranking interest in the goods; in reality, several have competing claims to the same assets.

Collateral management failures

In many commodity finance structures, lenders appoint independent collateral managers to monitor stored goods and verify the accuracy of warehouse receipts. These arrangements are only as effective as the quality and rigour of the monitoring actually performed.

Collateral management failures frequently arise where:

- Physical inspections are infrequent or superficial.
- Quantity verifications are based on documents rather than physical counts.
- The collateral manager relies on information provided by the borrower rather than independent sources.
- Commingled goods make it difficult to identify which specific commodities are subject to a particular receipt.
- Rotation of stock is not properly monitored, allowing pledged goods to be removed and replaced with inferior or insufficient quantities.

Complicit or compromised warehouse operators

Fraud is not always perpetrated by the borrower alone. In some cases, the warehouse operator itself is complicit, issuing receipts for goods it knows to be absent, over-represented or already pledged elsewhere, or allowing its stamps, systems or personnel to be used to authenticate documents without any genuine underlying stock check.

Because lenders and traders typically have no direct means of verifying stored goods other than through the operator's own records and attestations, a dishonest or captured operator can defeat even reasonably diligent due diligence by the financing parties. Risk increases further where the operator has a close commercial or ownership connection to the borrower, since the usual check provided by an independent third party is absent.

Forged or manipulated supporting documentation

Warehouse receipt fraud is also frequently supported by a wider package of falsified documentation, including fabricated weighbridge tickets, quality certificates, insurance certificates and audit confirmations, designed to withstand a lender's initial document review. Fraudsters may intercept or redirect verification requests sent to warehouse operators or surveyors, or use lookalike email domains and forged signatures, so that a lender believes it has obtained independent confirmation when in fact it has only received confirmation from the fraudster or an associate.

Absence of a centralised title or registry system

Unlike some forms of registered security, warehouse receipts are not generally recorded on a central, publicly searchable register. A lender taking a receipt as collateral usually has no straightforward way of confirming that the same goods have not already been pledged to another financier, particularly where the competing receipts are held by lenders in different jurisdictions or relationships that are not disclosed to one another. This structural gap in the market, rather than any single act of dishonesty, is what allows duplicate financing to persist undetected until a trigger event, such as a borrower default or a routine audit, brings the competing claims to light.

Fraud red flags

Parties involved in commodity finance should be alert to the following indicators that warehouse receipt fraud may be occurring:

- Reluctance by the borrower or warehouse operator to permit independent inspection.
- Repeated amendments to warehouse receipts or collateral reports.
- Discrepancies between documents provided by different parties in the same financing chain, including duplicate bills of lading, receipts or invoices issued through a common intermediary or freight forwarder.
- Unusual or unexplained movements of stock around inspection dates.
- Warehouse operators that are connected to or controlled by the borrower.
- Receipts issued for quantities or grades of commodity that are commercially implausible given the stated storage location.

What are the key legal issues – how do disputes arise?

Disputes in warehouse receipt financing typically crystallise when a borrower defaults, a routine audit is carried out, or a lender otherwise discovers that collateral it believed to be pledged exclusively to it does not exist, is insufficient, or has been pledged to other lenders as well. At that point, the priority for affected lenders and traders shifts quickly from understanding how it occurred to verifying what, if anything, remains of their collateral and pursuing the available remedies.

Fraud claims

In cases of fraud, there will be two key questions to consider at the outset:

- Is there enough evidence to pursue a claim of fraud? To do so successfully involves discharging a high burden of proof and there may not be enough evidence to meet this requirement.
- Can the fraudster pay? It is not uncommon for a fraud to be uncovered in the context of an insolvency, with the fraudster unlikely to be able to pay any judgment debt against them. Alternatively, the fraudster may have dissipated its gains, making recovery more difficult.

If there is not enough evidence, or if the fraudster is unlikely to be good for the money, it may be necessary to identify alternative means of recovery and it is a feature of warehouse receipt fraud disputes that victims will try to bring claims in both contract and tort against a number of parties, in order to maximise their chances of success.

Finally, securing a judgment against a fraudster may require asset tracing in order to recover what has been lost.

Title and possession disputes

Where fraud is suspected, lenders and traders must move quickly to verify the existence and ownership of stored goods. In practice, this means:

- Conducting unannounced physical inspections of storage facilities.
- Engaging independent surveyors to verify quantities by weight, volume or other relevant measure.
- Checking warehouse records directly against physical inventory.
- Comparing receipts held by different lenders to identify duplication.
- Reviewing the history of goods movements to establish whether pledged commodities have been removed.

Where shortfalls are identified, title and possession disputes will follow rapidly. Multiple parties may assert competing claims to the same goods, and priority questions will depend on the nature and timing of each security interest, the applicable law and the terms of the relevant contracts. Such disputes can also turn on technical questions such as whether a warehouse operator has attorned (that is, acknowledged that it holds the goods to a particular party's order), since tender of an endorsed receipt without attornment may not satisfy a seller's delivery obligations.

Claims against warehouse operators

Warehouse operators that issue false or duplicate receipts may be liable to those who relied on them. Potential causes of action include deceit, negligent misstatement and breach of bailment obligations. The strength of any such claim will depend on the nature of the representations made, the terms of the warehousing contract and whether the operator acted dishonestly or was itself deceived.

Where an operator is solvent, such claims may provide the innocent party with a meaningful avenue for recovery. Where the operator is also insolvent or controlled by the fraudster, recovery prospects are likely to be limited, and attention will turn to third parties, including banks that may have facilitated payments or provided services in connection with the fraud.

Coverage disputes

Many commodity finance structures include insurance arrangements covering the physical goods held as collateral. Coverage disputes can arise in this context and may involve:

- Arguments that the loss arose from fraud rather than a covered peril.
- Questions about whether the insured had an insurable interest in the goods at the relevant time.
- Non-disclosure or misrepresentation issues arising from the circumstances in which the insurance was obtained.
- Subrogation rights that may allow insurers to pursue recovery against those responsible for the fraud.

The role of English law remedies

English law offers a range of remedies to parties affected by warehouse receipt fraud. Where goods are located in England or where the relevant contractual arrangements are governed by English law, claimants may be able to obtain:

- Worldwide freezing orders preventing the dissipation of assets pending a final determination.
- Search and imaging orders enabling the preservation of relevant electronic and documentary evidence.
- Injunctions preventing access to or transfer of stored goods.
- Norwich Pharmacal and Bankers Trust disclosure orders compelling third parties, including banks and warehouse operators, to disclose information about the movement of assets.

The speed with which these remedies are obtained is often decisive. Once goods have been removed from storage, or proceeds have been dissipated, recovery becomes considerably more difficult.

Example Cases

Cases of warehouse receipt fraud have arisen in the metals, agricultural commodities and energy markets, and the sums at stake are rarely modest. The English courts have considered disputes arising from these frauds, and the resulting judgments are instructive for all parties operating in commodity finance.

The importance of attornment: the Qingdao metals scandal

The 2014 Qingdao port investigation uncovered fraud on a spectacular scale. Warehouse receipts covering aluminium and copper stored at facilities in Qingdao and Penglai were alleged to have been pledged multiple times to different lenders, including major international banks.

The resulting disputes generated litigation in many jurisdictions and highlighted the vulnerability of even sophisticated institutions to warehouse receipt fraud where independent verification of collateral is absent or inadequate.

One of the resulting disputes, *Mercuria Energy Trading Pte Ltd and another v Citibank NA and another [2015] EWHC 1481 (Comm)*, concerned a bank that held warehouse receipts issued to its order over metal purchased from Mercuria under repo financing arrangements. When the alleged fraud came to light, Mercuria disputed that the bank had validly redelivered the metal by tendering the endorsed warehouse receipts alone, since the warehouse operators had never attorned to Mercuria (that is, acknowledged that they held the goods to Mercuria's order). The Commercial Court agreed, holding that tender of the receipts without attornment did not satisfy the bank's delivery obligations under the Sale of Goods Act 1979 and the parties' master agreements. For more detail, see our briefing here.

Seeking recovery from multiple parties and asset tracing

In *ED&F Man Capital Markets Ltd v Come Harvest Holdings Ltd [2022] EWHC 229 (Comm)*, the Commercial Court found that two companies had used 92 counterfeit warehouse receipts, produced from colour-scanned copies of genuine receipts for nickel held by a third party, to obtain financing of over US$280 million from a bank under repo transactions. Upon discovery that the receipts were forged, the claimant bank served notice of rescission of its purchase contracts with the sellers on grounds of fraudulent misrepresentation. It then brought claims in tort amounting to more than US$280m against a number of defendants, including the sellers, agents and the owners of the nickel. The defendants were variously held liable in deceit and unlawful means conspiracy, and the bank's payments were traced into a constructive trust over assets in the hands of several of the defendants. For more detail, see our briefing here.

Which party bears the risk?

In *Natixis SA v Marex Financial and Access World Logistics (Singapore) Pte Ltd [2019] EWHC 2549 (Comm)*, sixteen purported warehouse receipts for nickel, delivered down a chain of repo sales, were later confirmed by the warehouse operator, Access World, to be forgeries. Access World had erroneously authenticated some of the forged receipts before the fraud emerged. The Court held the seller, Marex, liable to its buyer, Natixis, for breach of contract for failing to deliver genuine receipts to the metal. Importantly, it found that Marex bore the risk of the warehouse receipts being forged, underlining that liability can fall on the immediate contractual counterparty even where a warehouse operator further down the chain also played a role. For more detail, see our briefing here.

Coverage disputes

In *Quadra Commodities SA v XL Insurance Company SE [2023] EWCA Civ 432*, the Court of Appeal upheld a finding that a grain trader had an insurable interest in cargoes of Ukrainian corn and wheat that proved to be the subject of warehouse receipt fraud perpetrated by its sellers. The trader was entitled to recover under the misappropriation clause of its marine cargo insurance policy. The case confirms that buyers who pay against warehouse receipts later shown to be fraudulent may still have insurance recourse, provided they can establish an insurable interest in the goods at the relevant time.

HFW Comment

If you provide finance secured against commodity inventories, the risk of warehouse receipt fraud is a direct threat to your collateral position. Discovering that receipts are false or duplicated can eliminate the security on which lending decisions were based, leaving you an unsecured creditor of a borrower who may already be insolvent. It can also trigger immediate, often multi-jurisdictional, priority disputes with other lenders holding competing receipts over the same goods.

Where a fraud is uncovered early enough, tracing claims and proprietary remedies may allow recovery of funds even where the underlying goods have disappeared, but speed is essential.

How to reduce exposure to fraud

To reduce exposure to warehouse receipt fraud, we recommend the following steps:

- Conduct independent, unannounced physical inspections of collateral at regular intervals throughout the life of any financing arrangement.
- Use collateral managers with a genuine operational independence from the borrower and with sufficient resources and authority to carry out meaningful verification.
- Review the terms of warehousing contracts to ensure receipts carry clear statements of what is and is not warranted by the operator.
- Explore the adoption of electronic or blockchain-based warehouse receipts, which create an immutable record and reduce the risk of duplication.
- Establish a clear protocol for sharing collateral information between co-lenders where syndicated or parallel financing arrangements are in place.
- Maintain updated records of all receipts held as security, and cross-check against other financing involving the same counterparty and storage locations where possible.
- Independently verify the underlying trade documentation supporting any financing, including invoices, receipts and bills of lading, against information obtained directly from carriers, counterparties or other independent sources, rather than relying solely on documents supplied by the borrower or its intermediaries.
- Where financing depends on a trading counterparty's creditworthiness rather than title to specific goods, monitor for related-party dealings and signs of financial distress, and consider seeking early assignment of claims against directors if insolvency appears imminent.
- If fraud is suspected, take legal advice immediately and move quickly to preserve evidence and obtain injunctive relief before goods are removed.
- Notify insurers and review coverage in light of the circumstances as soon as a potential claim becomes apparent.

HFW regularly advises on warehouse receipt and commodity finance structures, disputes arising from fraud and duplicate financing, and related recovery and coverage issues. If you would like to discuss warehouse receipt fraud risks, collateral management arrangements or recovery options following commodity finance losses, please contact a member of HFW's commodities, trade finance or insolvency teams.

If you require any further information or assistance with any of the issues dealt with in this guide, please contact the authors:



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