Item No. 8 on the agenda: Triennial Work Programme of the Organisation (2009-2011) –

(d) Possible future work in the area of private law and development

(i) Private Law Aspects of Agricultural Finance

(submitted by the Secretariat)

<table>
<thead>
<tr>
<th>Summary</th>
<th>Consideration of possible future work in the area of private law and development</th>
</tr>
</thead>
<tbody>
<tr>
<td>Action to be taken</td>
<td>Request for authorisation by the Council to continue preliminary research</td>
</tr>
<tr>
<td>Mandate</td>
<td>Future Work Programme</td>
</tr>
<tr>
<td>Priority level</td>
<td>To be determined</td>
</tr>
<tr>
<td>Related documents</td>
<td>C.D. (88) 7 Add. 6; C.D. (88) 17</td>
</tr>
</tbody>
</table>

INTRODUCTION

1. At its 88th session, the Governing Council considered a memorandum by the Secretariat containing a number of preliminary thoughts on the possibility of UNIDROIT opening a line of work specifically devoted to the interplay between private law and economic and social development (C.D.(88) 7 Add. 6).

2. In its consideration of those proposals, the Governing Council recalled the repeated appeals that had been made in recent years to the effect that UNIDROIT should give adequate consideration to the needs of developing countries when formulating recommendations for the Work Programme of UNIDROIT to the General Assembly. The Council agreed that the broad mandate of UNIDROIT in the area of private law offered a wide range of opportunities for the organisation to contribute to the achievement of development goals agreed upon by the international community. Opening a line of work specifically devoted to the interplay between private law and economic and social development, in particular in the area of agricultural investment and production, but also in the area of legal aspects of social businesses might also permit to better explore synergies with other inter-Governmental organisations and to develop joint projects in co-operation with them.¹

This memorandum sets out the results of the preliminary research undertaken by the Secretariat in one particular area described in document C.D. (88) 7 Add. 6, namely the interplay between private law and agricultural investment and production. It concludes by suggesting the particular focus which the work of UNIDROIT might take, so as to offer a useful supplement to, but not a duplication of, the work done by other organisations, such as the Food and Agriculture Organization of the United Nations (FAO) and the International Fund for Agricultural Development (IFAD).

The Secretariat notes that a large part of the work done by international organisations in legal aspects related to agricultural investment and production has focused on the implementation of broad policy objectives, such as the promotion of agriculture for purposes of poverty alleviation, legal empowerment of small farmers, in particular women, human and social development of rural population, adherence to environmental protection or food safety standards. The Secretariat proposes that any work that UNIDROIT might decide to undertake should not venture into any of those areas and should instead be clearly focused on private law issues from the perspective of the needs of commercially-operating agricultural enterprises. Considering the past work done by UNIDROIT in legal aspects of financial transactions, in particular equipment financing, it is submitted that a particular subject that UNIDROIT might usefully examine is that of legal instruments and mechanisms for agricultural investment and financing, both in terms of legal implications related to particular investment and funding trends or recent transaction patterns, but also as regards the long-term legal framework for commercial agricultural investment and production. It is suggested that UNIDROIT could approach this area by examining the fundamental elements of a favourable private law framework for agricultural investment and commercially sound production and marketing, and what guidance UNIDROIT might provide to assist countries develop such a framework.

A. RECENT TRENDS IN AGRICULTURAL INVESTMENT AND FINANCING

Agricultural production has attracted keen attention by the international community and media in recent years. Sudden rises in the prices of agricultural commodities, particularly in the years 2007 and 2008, coupled with the expected expansion of demand for those commodities as a result of demographic developments and the rise in the standards of living in some parts of the world, have spurred widespread concern about the ability of the agricultural sector to ensure a level of production sufficient to satisfy the world’s future demand for food. Arable land and water – the two most basic resources for agricultural production – being by nature limited, serious concerns have arisen as to whether the way those resources are being used is efficient enough to secure the needs of a growing world population. At the same time, sharply increasing prices for energy sources and concerns about the impact of mineral fuels on the environment (“climate change”) have raised the demand for renewable energy sources, and diverted some agricultural investment from food production into production of so-called “bio-fuels”, further exacerbating the perceived shortage of food supplies.

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2 A wealth of information on land reform, in particular as regards its social impact, the interplay with human settlement and poverty alleviation policies can be found in the FAO publication series “Land Reform, Land Settlements and Cooperatives” (<http://www.fao.org/sd/ltdirect/landrf.htm>, 15 March 2010).

3 Legislative advice on these specific areas is provided by the FAO Legal Office in the country and regional projects of that organisation. General studies are regularly published in the series “Legislative Studies” (<http://www.fao.org/legal/pub-e.htm>, 15 March 2010).

4 According to the FAO, liquid biofuels based on agricultural commodities increased more than threefold from 2000 to 2008, by which date they accounted for about 10% of global coarse-grains utilisation (FAO background document for the World Summit on Food Security, FAO, Rome 16 – 18 November 2009: Feeding the World, Eradicating Hunger). “[A]gainst the background of increasing food demand and the scarcity of farm land, land values are expected to rise, which is giving way to speculation. In 2007, for example, it is indicated that the prices for farmland in Brazil and Poland increased by 16% and 31% respectively. Farmland is emerging as an asset class and investments in land have particularly attracted the interest of investors recently. The consolidation of small plots into larger ones with the aim of increased productivity and efficiency has become an investment opportunity for agribusiness investors. Recent trends furthermore include an increased participation
6. "Food security" soon became an item on the agenda of high-level political gatherings. There has been no particular extension of the notion of "food security" to the area of private law, which is of particular interest for UNIDROIT. Nevertheless, the issues raised in the debate about "food security" reveal a number of concerns that may have implications in the area of private law, and which may be worthwhile to explore further. Indeed, the confluence of new demands to derive products from land and natural resources is generating a "commercially-driven demand for new land". At the same time, financial markets seem to have discovered agriculture as a potentially profitable area of investment. The result has been a rapidly growing foreign direct investment in agriculture and the creation of a variety of financial instruments and vehicles for mobilising capital for the rural sector.

1. **FOREIGN DIRECT INVESTMENT (FDI)**

7. Foreign Direct Investment (FDI) in agriculture may take various forms, from indirect, non-equity participation through implementation of standards and other information-intensive relationships in which a target country farmer/firm produces to the specifications of a foreign TNC, direct, non-equity participation through contract farming, to direct equity participation through FDI, whereby coordination and control of transactions are fully internalised within a transnational corporation. At least two distinct basic motivations for agricultural FDI can be identified:

   (a) **Export-driven investment.** In recent years some large rural investments seem to have been made primarily for the exclusive purpose of producing crops for export. Sometimes the crops are primarily intended as a reserve to secure the food or bio fuel needs of the country of origin of the investment. In other cases, the intention is simply to supply the international market, without a specific link to trade with a particular country; or

   (b) **Domestic-market investment.** Most agricultural investment, however, originates from domestic sources. Even where it is financed internationally, it is not necessarily intended to supply foreign markets. Domestic investment in agriculture has increased in many countries, in much the same way as foreign investors may provide equity or debt capital for agricultural enterprises that produce commodities are not necessarily earmarked for exportation.

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5. "Food security" is a complex concept that has various inter-disciplinary facets. In its most basic sense, it means the physical and economic access to sufficient, safe and nutritious food to meet the dietary needs and food preferences for an active and healthy life (World Food Summit, 1996). The notion of "food security" is a manifestation of the broader concept of "right to food", which is understood as "the right of every person to have continuous access to the resources necessary to produce, earn or purchase enough food not only to prevent hunger, but also to ensure health and well-being." FAO and WFP, *The State of Food Insecurity in the World, Economic crises - impacts and lessons learned*, Rome 2009, 46-47. The notion of "right to food" derives from the Universal Declaration of Human Rights (Art. 25) and of the International Covenant on Economic, Social and Cultural Rights (Art.11).

6. It is estimated that out of the 515 million hectares of land required for the production of agricultural, energy and forestry commodities by 2030, only 250 to 300 million hectares of land are globally available, the remaining 200 million will have to be obtained from forestland (The Rights and Resources Initiative, *Seeing People Through the Trees: Scaling Up Efforts to Enhance Rights and Address Poverty, Conflict and Climate Change*, July 2008 <http://www.rightsandresources.org/documents/files/doc_791.pdf>, 11 March 2010).


8. Reports on the acquisition of large land holdings in developing countries by foreign investors have found their way into daily newspapers and weekly magazines. Much negative publicity has resulted from so-called “land grab” deals in which land is allegedly given away cheaply and without adequate regard for the rights of tenants or owners and without proper environmental assessment or economic sustainability. There is also growing concern among Governments, international organisations and civil society that “poorly conceived or executed investments, particularly those involving large tracts of land in developing countries, could have unintended negative impacts in terms of political stability, social cohesion, human security, sustainable food production, household food security or environmental protection for the receiving country.” Fears that the local population “could lose access to the resources on which they depend” further strengthen the feeling that “measures to mitigate negative impacts associated with large-scale international investments in developing countries are urgently needed.” A consensus is also developing on the need to formulate guidelines or codes of conduct to govern large-scale FDI in the agricultural sector of developing countries around a set of core principles. The World Bank, the Food and Agriculture Organisation of the United Nations (FAO), the International Fund for Agricultural Development (IFAD) and the United Nations Conference on Trade and Development (UNCTAD) are the leading agencies in this process, which is expected to involve a wider range of stakeholders, particularly investors and civil society organisations.

9. Leaving aside the above-mentioned social and policy concerns for a moment, it is important to note that FDI for agricultural production does not have to be a negative development. In fact, foreign investment is frequently a welcome boost, and offers significant potential to complement public resources. Many countries with reasonably functioning markets have derived significant benefits from it in terms of better access to capital, technology and skills, generation of employment, and productivity increases. Moreover, new technology, the emergence of value


11. Ibid.

12. Such as that existing rights to land and natural resources are recognised (“Land and Resource Rights”); that investments do not jeopardise food security, but rather strengthen it (“Food Security”); that processes for accessing land and making associated investments are transparent, monitored, and ensure accountability (“Transparency, Good Governance and Enabling Environment”); that those materially affected are consulted and agreements from consultations are recorded and enforced (“Consultation and Participation”); that projects are viable economically, respect the rule of law, reflect industry best practice, and result in durable shared value (“Economic viability and responsible agro-enterprise investing”); that “investments generate desirable social and distributional impacts and do not increase vulnerability (“Social Sustainability”); and that “environmental impacts are quantified and measures taken to encourage sustainable resource use, while minimizing and mitigating their negative impact (“Environmental Sustainability” (“ibid., para.6).


14. Besides indirect positive impacts (such as know-how transfer, better integration of the local economy into added value chains or other spill over impacts for the local economy), direct positive socio-economic effects may include: increasing productivity on agricultural land; valorising or augmenting of marginal land by melioration measures (i.e. irrigation schemes, dams, terraces, etc.); market access for farmers in rural areas of developing countries; generating income by leasehold; generating tax income by levy land taxes or land transfer tax, the establishment of new firms, by the increase of employment and by raised consumption; improving infrastructure by building roads, or investing in transportation and communication; or increasing agricultural exports due to increasing overall productivity and product quality (Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), Foreign Direct Investment (FDI) in Land in developing countries, GTZ, Eschborn, 2009, pp. 21-22)
chains, demands for traceability, the need to adhere to rigorous standards, and consumer demands arguably favour greater scale and integration. Some large investments have managed to achieve broad-based benefits via contract farming and joint ventures with local communities, by leasing rather than acquiring the land or by formulating innovative schemes for sharing both risks and rewards.\footnote{Principles for Responsible Agricultural Investment that Respect Rights, Livelihoods and Resources (A discussion note prepared by FAO, IFAD, UNCTAD and the World Bank Group to contribute to an ongoing global dialogue, January 25, 2010), p. 1.}

10. Obviously, investment decisions will be taken following an evaluation of a number of fundamental economic conditions (e.g. transportation infrastructure, monetary and economic stability, market size), as well as some crucial aspects of the legal environment, such the level of legal protection afforded to investors. Private law may not be an evident factor in this equation, but the long-term sustainability of FDI will require a favourable legal framework. Obsolete or inefficient laws may discourage agricultural production or deprive farmers or agricultural enterprises of the legal certainty and predictability needed for their investment. They may also pose obstacles to commercialisation of agricultural products or limit access to credit needed for modernisation or expansion of agricultural production.

2. **Commercial Lending and Capitalisation through Financial Markets**

11. Rural financial markets in most countries consist of various intermediaries: agricultural development banks, commercial banks, rural unit banks, co-operatives, NGOs, informal financial institutions and individual moneylenders.\footnote{Thorsten Giehler, *Sources of Funds for Agricultural Lending, Agricultural Finance Revisited Study No. 4*, published under the joint auspices of the FAO and GTZ, 1999, ix.}

12. Commercial banks have a long tradition in extending credit to agricultural enterprises, and a number of financial products and instruments have been especially developed to meet the needs of the rural sector. The recent increase in prices for agricultural commodities, the expanding alimentary needs of the world’s population and the growing market potential for renewable energy sources have led international commercial banks that specialise in agriculture to make “a strong push into the microfinance sector and their asset management subsidiaries are investing, like other institutional investors, in the emerging market agricultural sector.”\footnote{Patrick E. McNellis, *Foreign Investment in Developing Country Agriculture – The Emerging Role of Private Sector Finance*, FAO Commodity and Trade Policy Research Working Paper No. 28, Rome, 2009, 20.} International investment banks are mostly active in the developing world agricultural sector through their money management entities, “prop desks”, private equity departments and through their strong capabilities in the commodity trading markets.\footnote{Ibid.}

13. The penetration of commercial banks in new market segments in developing countries has also stimulated the development of special financial products and instruments.\footnote{E.g. Cashless micro-credit programmes, DrumNet (an emerging network of rural area farm business support centres delivering agricultural extension, credit, and marketing services to smallholder horticultural farmers) – see World Bank, Agriculture And Rural Development Department, *Rural Finance Innovations Topics and Case Studies*, Report No. 32726-GLB, Washington 2005, 28.} At the same time, however, recent surveys indicate that more traditional commercial banks may be reluctant to lend money for agriculture, particularly in developing countries and that deficiencies in the legal framework prevent a number of countries from making use of innovative financial instruments to mobilise funds for the rural sector.\footnote{See *Rural Finance Innovations Topics and Case Studies*, Report No. 32726–GLB of the Agriculture and Rural Development Department of The World Bank, 2005.}
lending activities for agriculture is that of high risk exposure due to inadequate collateral (see below, paras. 25 to 36).

14. In addition to commercial banks, capital for agricultural investment and finance is increasingly being mobilised through investment funds. There are a number of different types of investment funds, most of which diversify their financing, including also agriculture. The investment in agricultural farmland is growing in attractiveness, especially after the crisis of the financial markets in 2008/2009: “[t]he idea is to buy farmland in areas with inexpensive and fertile soil […], to consolidate small plots of land into larger more productive units and to farm the acquired land, at the same time introducing new technologies and investing in additional infrastructure and equipment. […] Overall, a growing number of investment funds investing in farmland globally are currently being perceived.”

15. Equity and private equity funds “represent the largest share of the identified funds both in terms of capital base and number of funds.” Generally, they target either the capital needs of the “missing middle” or those of larger, agro-processing and –producing companies, with a focus on the latter. Depending on the target market, “investor base and investment strategy, the equity funds identified comprise both funds that invest in a narrowly defined type of business and funds that have a broader approach to investing in agriculture through providing capital along the agricultural value chain, ranging from input supply, production and processing to distribution, agricultural infrastructure, farmland and food storage or even food retailers.” There are also debt funds or mixed equity/debt funds and guarantee funds providing capital to the rural sector, and even a few hedge funds.

16. It goes without saying that sustainable FDI or other forms of agriculture investment through financial markets require a favourable general legal environment that helps mobilise capital and reduces the legal risk to which equity and debt providers are exposed. Of particular importance, from the point of view of private law, is the need for “secure property rights as well as contract enforcement and execution rights”, which play a “particular role with regard to land markets in developing countries”. However, recent studies have identified a number of weaknesses in the private law framework that hinder the development of effective rural financial markets.

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21 Miller and Richter, supra note 4, 39
22 Miller and Richter, supra note 4, 10. The study on “Foreign Investment in Developing Country Agriculture – The Emerging Role of Private Sector Finance” points out that “[t]he most common investment strategies in private equity include leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital. Typically, private equity firms seek to buy majority control of an existing or mature firm through the use of leverage (using debt). This is distinct from a venture capital or growth capital investment, in which the private equity firm typically invests in young or emerging companies, and rarely obtains majority control. […] there appears to be increased interest among a number of the private equity funds in putting more money to work in the emerging market and a number of these funds are specifically focusing on the agricultural sector (McNellis, supra note 17, 14).
23 That is, capital needs between US$ 10,000 up to US$ 1 million (Miller and Richter, supra note 4, 10).
25 Ibid.
26 McNellis, supra note 17, 13. The author cites the example of New York-based BlackRock Inc, one of the world’s largest money managers, which in September 2008, set up a USD200 million agricultural hedge fund, of which USD30 million will reportedly be used “to acquire farmland around the world.” (Ibid.)
27 Miller and Richter, supra note 4, 53
B. FINANCING TRANSACTIONS AND THEIR LEGAL RISKS

17. The previous section has briefly described the growing role of transnational agricultural investment and the expanding domestic financing market for the rural sector. These sources of capital may be directed to a wide range of transactions in the agricultural sector. For the purposes of this memorandum, these transactions can be broadly divided into three main areas, namely: financing of land acquisition and facilities development; purchase of equipment, livestock and machinery; input and crop financing.

18. A number of financing structures and vehicles may be used, individually or in a combined fashion, in any of these broad areas. Indeed, most vehicles or structures are not specific; they can be used for the financing of equipment as well as of land or crops. By the same token, while each of these broad transaction areas may have specific collateral and guarantee requirements or may make preferential use of a particular type of security, various types of instruments may be used to secure the lenders and other creditors in each of those three broad areas.

1. TRANSACTION STRUCTURES

   (a) Land acquisition and facilities development

19. The first group of transactions for which agricultural finance is available is for heavy implements like storage facilities, making land improvements, buying land for increase in farm holding size. Commercial loans for these types of investment are typically of long-term nature and secured by a variety of collateral. Besides personal guarantees that may be demanded from the borrowers, or the pledge of shares in the corporation that controls the agricultural business, security is often provided in the form of mortgage attaching to the land and facilities.

   (b) Operation loans

20. Operation loans, usually on a medium term-basis, are typically provided for investment such as buying livestock, agricultural implements, machinery or equipment, for facilities improvement (for example, sinking of well) and similar purposes. In addition to mortgages or other financial and other types of collateral security also available for financing the acquisition of land or the expansion of an existing agricultural business, a certain number of financial instruments and collateral security are specific for the financing of equipment, such as equipment leasing.

   (c) Input and crop financing

21. Lastly, seasonal – and therefore typically short-term – agricultural finance (often only up to harvesting) is often sought by farmers to meet temporary needs like buying of seeds, fertilisers, for meeting expenses of seasonal works.

22. The most basic transactional structure for seasonal financing is the provision of loans secured by some classical form of collateral. However, difficulties faced by farmers in financing seasonal input purchases for food grain production is said to be a major problem constraining agricultural growth in many parts of the developing world. This problem is acute in the case of small farmers, while farmers operating on a commercial scale would typically have a greater ability to offer collateral acceptable to lenders. Nevertheless, inefficient or outdated laws on secured transactions potentially limit the access to credit or raise its cost for the entire rural sector.

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23. In addition to those types of collateral that are also used to structure long and medium-term financing transactions, a number of special instruments play a particular role in agricultural finance. Warehouse receipts, for instance, have long been used to secure credits to the agricultural sector. As negotiable instruments, warehouse receipts can be traded, sold, swapped, used as collateral to support borrowing, or accepted for delivery against a derivative instrument such as a futures contract. Warehouse receipts allow for the use of stored goods as loan collateral. Typically, a document is issued by a warehouse listing the goods or commodities deposited in the warehouse. The depositor can then use that receipt as a pledge to secure a loan from a bank or other lender. The lender places a lien on the commodity, so that it cannot be sold without the proceeds first being used to repay the outstanding loan. Warehouse receipts may be used as collateral to support trade in a commodities exchange, but also as a credit enhancement in agricultural securitisation. Indeed, investors “may not be very keen to finance, at low rates, most of the domestic companies active in the production, processing and trade of commodities, but the credit upgrading provided by the use of warehouse receipts may make a difference.”

24. In a number of countries, other special categories of negotiable instruments have been created to ease the access of commercial farmers to capital markets. Typically, these new instruments are backed by a pledge of receivables and other assets owned by the farmer or the marketing intermediaries (such as a cooperative, a trader or a wholesale buyer of the relevant commodities) trading in the commodities. In some countries, special securitisation vehicles have been created for the issuance of securities backed by assets or receivables originating from agriculture.31 These types of transactions support long-term marketing and distribution arrangements in the agricultural sector, such as direct sales of rights to future commodity production to investors.32 Securitisation has been said to be a useful mechanism to reduce the cost of government-sponsored agricultural loan programmes.33

2. **Legal Obstacles to Efficient Agriculture Finance**

25. The provision of credit to finance agriculture investment and production exposes the lender to a default risk that may be higher than in other areas of commercial lending. By their very nature, income streams generated from rural businesses are seasonal and sometimes erratic in nature. A rural property may have a high nominal value but may not always be able to generate a steady cash flow, which reduces the actual value of land as collateral. Additional factors that increase the inherent risk in agriculture finance include productivity loss due to climatic events such as droughts and floods, major outbreaks of pests and diseases, or commercial risk due to sudden

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31 For example, one of the new financial instruments introduced in Brazil by Law 11.076/04 of 31 December 2004, the “certificate of agribusiness receivables” can only be issued by special purpose vehicles incorporated as publicly held companies for the purpose of acquiring and securitising agribusiness instruments. To issue those instruments, the securitisation company typically negotiates and acquires the agribusiness credit rights from rural producers, agribusiness companies and financial institutions; links such credit rights to a specific series of CRAs by agreeing on a credit rights securitisation instrument; and places the series of CRAs with public investors (see Ronald Herscovici, Eduardo J Herszkowicz and Frederico M Stacchini, “Securitisation of agribusiness financial instruments in Brazil: an expanding market,” *Global Securitisation and Structured Finance 2008*, London: Globe White Page Ltd (2008), pp. 32-36).


price declines or drastic changes of macroeconomic parameters affecting demand for agricultural commodities. These risks lead capital-constrained investors into making less expensive but often less profitable investments, with shorter gestation periods.

26. Debt capital is also not as largely available as needed, particularly in developing countries, many banks maintain 50% or more of their total deposits in liquid assets and provide minimal credit to the private sector. 34 The restrictive credit policy of those banks is to some extent attributed to greater exposure to default risk due to lengthy and costly contract enforcement mechanisms. It has been reported that “lenders impose very high collateral requirements which borrowers often cannot satisfy because they do not have adequate legal title to assets.”35

27. As indicated in the following paragraphs, farmers in developing countries get little advantage from offering property as collateral for loans due to the fragmented nature of the regulations that govern the creation of security interests and problems with registration of title.36 Registry systems may exist only for certain types of assets and are often located in major cities far from rural areas. Even if a security interest in the asset can be created and perfected, it has been noted that “there are risks related to high transaction costs and delays in foreclosing and selling.”37 Inefficient enforcement and foreclosure procedures may be a particular problem in the case of movable assets subject to depreciation such as machinery, equipment or livestock.

(a) Legal limitations on the availability of real estate as collateral

28. Real estate is often the preferred form of collateral for larger, long-term credits, because these assets are more likely to maintain their value during the maturity of the loan. However, several problems can complicate the use of real estate in securing loans.

29. Farmers may not have formal rights (legally recognized and enforceable) to land or other fixed assets, as is often the case in customary land-tenure systems. In other cases, land titles might exist, but legal restrictions regarding the transfer of property rights, or social concerns about dispossession of small farmers may make immoveable property unsuitable as a collateral. 38 Larger farm holdings, in turn, may be less likely to entirely lack proper property titles, but land transactions may still be hindered by inefficient title registries or inadequate procedures or standards for recording transfers of title through inheritance or sales.39

36 Fleisig and De la Peña, supra note 28, 4 et seq.
38 Indeed, the social nature of microcredit for the rural sector institutions is said to incompatible with the financing principles and mechanisms developed for financing commercial farming (Ernesto Parra Escobar Bogotá, “El impacto de la microempresa rural en la economía latinoamericana,” Revista Futuros No. 13, 2006 Vol. IV (<www.revistafuturos.info/raw_text/raw.../microempresa%20rural.doc >, 21 March 2010).
39 In some parts of Brazil, for example, land registries failed in the past to open new registries for fractions of land sold or inherited within larger plots, or did not systematically update the description of the boundaries of such fractions of land. The result was a very high number of rural properties operating within physical boundaries that no longer corresponded to the registered title deeds. Federal Law No. 10.267, of 28 August 2001, introduced the requirement of prior measurement of the property by geodetic referencing methods as a condition for registration of transfers and conveyances (Diário Oficial da União, 29/08/2001). By and large, the new law was positively received as a welcome mechanism to achieve greater accuracy in land titles. Implementation of the new system, however, has been slow due to technical difficulties, unclear regulations and the cost of the new measurement system. This led to many mortgage deeds being refused for registration, but also to blockage in the release of funds for crop financing (Burocracia jurídica “trava” uso de R$: 1 bilhão em Mato Grosso, Agência de noticias “Primeira Hora”, 28/01/2010 (<http://www.primeirahora.com.br/noticia-imprimir.php?intNotID=24857>, 21 March 2010).
30. Moreover, in particular, outdated or costly rules on security interests in immoveable property may limit the collateral value of land. Empiric research from some countries has indeed confirmed that the reasons given by lenders for not accepting agricultural land as collateral, among purely economic considerations (low price of agricultural land or lack of a functioning land market) are inefficient laws on mortgages. The high cost of creating a mortgage in most countries may make it uneconomical for medium or small rural enterprises to use their land titles to secure loans. This problem becomes even greater in legal systems where a new registration is needed every time the debtor wishes to use the same property to secure a new loan, thus increasing the cost of perfecting the mortgage.

31. Another problem identified in practice concerns procedures for the foreclosure on mortgaged property in the event of default by the borrower, which are often costly and time-consuming. Average delay in legal proceedings of up to five years, depending on the jurisdiction, is said to “affect the practical utility of collateral, and as a consequence lenders restrict collateral-based lending.” In many legal systems, the availability of land as a collateral presupposes the existence of clearly ascertainable property title, a requirement that impedes the use of other economically significant rights to use the land, and it has been suggested that efforts should be made to “codify all economically important land use rights” and “broaden such land-use rights projects to include a clear and simple legal mechanism for transferring land-use rights and using them as collateral.”

32. Inability to use their assets as collateral may force farmers to rely on other sources of loans, which may require little or no physical collateral, but may make smaller loans at higher interest rates. The distribution of economic activities “is then tilted in favour of those who can offer the best collateral, preferably urban real estate.”

(b) Legal limitations on the use of movables as collateral

33. In countries where land sales or rental markets are poorly developed, legal provisions for using movable assets as collateral (farm machinery and equipment, cars or livestock) may be of crucial importance. In many countries, however, such a legal base is either not in place or inappropriate legal provisions constrain its use in practice. For example, limitations to the availability of rural credit are in many countries the consequence of traditional rules that require the specific identification and enumeration of property offered as collateral, i.e. identifying the specific animals in a herd, rather than accepting a floating security interest in the cattle, described only by their total monetary value.

40 Renée Giovarelli, Mortgage in the Bulgarian Agricultural Sector, Rural Development Institute Reports on Foreign Aid and Development No. 104, Seattle 2000, 1.
41 This is one of the justifications given, for instance, for the recent reform of the French mortgage system, which as part of the overall modernisation of secured transactions laws in France, introduced the notion of a “rechargeable mortgage” to allow for the reutilisation of the same property and the same mortgage as collateral for new debt without the need for a new deed, even if the new loan is provided by a different creditor (see Groupe de travail relatif à la réforme du droit des sûretés, rapport à M. le garde des Sceaux, ministre de la justice, Paris, Ministère de la justice, 28 mars 2005, p. 18 (<http://www.ladocumentationfrancaise.fr/rapports-publics/054000230/index.shtml>, 25 March 2010).
42 Frank Hollinger supra note 37, section 7.1.3.
43 Fleisig and De la Peña, supra note 28, p. i.
44 Frank Hollinger supra note 37, section 7.1.1.
45 The reform of the secured transactions laws in France acknowledged the limitations posed by the old system to the availability of credit and rendered the creation of collateral more flexible by allowing a charge to attach to stocks and inventory, including futures (see Groupe de travail relatif à la réforme du droit des sûretés, supra note 41, p. 11.
34. Additional problems result from the possessory nature of security interests in moveable property. The requirement of physical transfer of the assets to the secured creditor deprives the debtor of the economic benefit from the asset and makes it difficult to pledge bulk assets, livestock inventory or futures. This is why, over the years, “many States have abandoned the rule prohibiting the creation of non-possessory security rights in movable assets.” In several of these States, however, only certain types of asset may be encumbered by non-possessory security rights and only certain types of grantor may grant non-possessory security rights. Another difficulty results from the fact that “[m]any States do not permit multiple security rights in the same movable assets”, which means that “a grantor is effectively required to dedicate the full value of an asset to a single creditor, even when the asset has a much higher value than the credit it secures.”

35. The overriding interest of avoiding hidden liens by promoting publicity of security interests and the wish to establish efficient mechanisms to determine the relative priority of secured creditors are two of the main reasons for the broad consensus that has emerged in recent years advocating the establishment of registry systems to record security interests in moveable goods. Registration of security interests ensures that there is no senior claim on the asset and avoids the possibility of the asset being pledged to different lenders. It requires laws that clearly define priority and provide for registration of the security interest against the asset within appropriate registration systems.

36. In this context the proposal to prepare a fourth Protocol to the 2001 Cape Town Convention on International Interests in Mobile Equipment specific to Agricultural, Construction and Mining Equipment should be considered. In the words of the Official Commentary, the principal objective of the Cape Town Convention is to achieve “the efficient financing of mobile equipment. […] The Convention system is designed to bring significant economic benefits to countries at all stages of economic development, and in particular to developing countries by bringing within their reach commercial finance for mobile equipment that has previously been unavailable or available only at relatively high cost. A sound, internationally adopted legal regime for security, title-retention and leasing interests will encourage the provision of finance and reduce its cost”. The sometimes substantial costs that farmers have to face when they consider the acquisition of equipment may speak in favour of extending the Cape Town system also to agricultural equipment. The possibility of thereby facilitating foreign investment as a result of the greater guarantees offered an investor is an additional consideration in the evaluation of the desirability of UNIDROIT engaging in the preparation of such a Protocol.

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47. *UNCITRAL Legislative Guide on Secured Transactions*, para. 67.

48. A pioneer instrument in this area, the Model Law on Secured Transactions prepared by the European Bank for Reconstruction and Development (EBRD), for instance "works on the principle that charges are a matter for public knowledge. Since Roman law the creation of secret rights in assets has been disfavoured. A person who gives assets as security but does not indicate this to his creditors creates an impression of 'false wealth'. The Model [Law] achieves publicity mainly by relying on registration of charges at a separate registry" (EBRD, Model Law on Secured Transactions, London, 2004). A positive recommendation for the introduction of a registry system is also made by UNCITRAL (*UNCITRAL Legislative Guide on Secured Transactions*, para. 54; the Organisation of American states (OAS) in its Model Inter-American Law on Secured Transactions, prepared in 2002 (see article 10) and by the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the World Bank (see IFC, *Secured Transactions Systems and Collateral Registries*, Washington, D.C. 2010).

49. See *UNCITRAL Legislative Guide on Secured Transactions*, recommendations 54-75. For a discussion of practical experiences with and implications of collateral registries see IFC, *supra* note 48.

37. Warehouse receipts can be especially useful in developing and transition economies where new market instruments need to be created. In many countries there is a severe scarcity of attractive 3-12 months investment vehicles, so the issuance of such papers could be expected to attract considerable interest from corporate treasurers and individual investors alike. Such papers could be placed privately, or could be traded on stock or commodity exchanges.\(^{51}\) However, their use is limited in many developing and transition countries because of institutional and structural shortcomings, including a lack of "institutional environment to support a system of warehouse receipts; and limited, if any, familiarity of the country's commercial, including its banking, community with warehouse receipts."\(^{52}\) The lack of an appropriate legal environment is considered to be the single most important constraint on the creation and acceptance of warehouse receipts in many developing countries and in most countries in transition.\(^{53}\)

38. One fundamental condition for the viability of a warehouse-receipt system is that the law must facilitate their pledge as collateral. In order to achieve that result, the holder in due course of a warehouse receipt should be given constructive possession of the stored commodities and the warehouse receipt should be negotiable by delivery and endorsement. Furthermore, the holder of a warehouse receipt should have priority to receive the stored goods or their fungible equivalent on liquidation or default of the warehouse, and a prospective acquirer of a warehouse receipt should be able to determine, before acceptance, if there is a competing claim on the collateral underlying the receipt.

\(d\) Lack of appropriate leasing legislation

39. Leasing is a method of equipment finance that is particularly advantageous for new, small and medium-size businesses that do not have a lengthy credit history or a significant asset base for collateral. The lack of a collateral requirement with leasing is said to offer "an important advantage in countries with weak business environments, particularly those with weak creditors' rights and collateral laws and registries, for instance, in countries where secured lenders do not have priority in the case of default."\(^{54}\)

40. Leasing is of growing importance in microfinance,\(^{55}\) but seems to be underutilised in rural finance.\(^{56}\) Yet, leasing offers an important tool for the acquisition of new equipment by farms and other rural enterprises without access to long-term credit because of insufficiency of collateral. Indeed, it has been noted that in many jurisdictions most assets that rural enterprises own cannot be used as collateral: titles to land are often nonexistent and movable assets such as livestock and warehouse receipts are not legally permissible as collateral. Leasing is a financing tool that overcomes this constraint.\(^{57}\)

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\(^{52}\) Ibid., 4 – 5.

\(^{53}\) Ibid., 37 – 38. See further the list of legal issues in also Jonathan Coulter and Andrew Shepherd, "Inventory Credit: An Approach to Developing Agricultural Markets." Agricultural Services Bulletin 120, FAO, Rome 1995, Annex. Obviously, laws on warehouse receipts would not suffice, by themselves, to create a market for these instruments in the absence, for instance, of a functioning private storage industry or an inefficient intervention in agricultural markets that preclude profitable storage.


\(^{57}\) Ibid., viii.
41. Leasing often requires specific legislation. UNIDROIT has prepared two instruments on leasing: the 1988 UNIDROIT Convention on International Financial Leasing, which is limited to financial leasing, and the 2008 UNIDROIT Model Law on Leasing which is not limited to financial leases, but also deals with all form of commercial leases. It is above all the Model Law which may assist countries without legislation on leasing to prepare legislation.

CONCLUSION

42. Recent developments suggest that there are at least two levels at which an international organisation with the particular mandate and expertise of UNIDROIT might contribute to improving and modernising the private law framework for agricultural investment and production:

(a) in connection with discrete private law aspects of FDI in the rural sectors; and

(b) in connection with the modernisation of the domestic rules of private law that affect agricultural investment and production or the availability of capital to finance the rural sector.

43. As noted above, the World Bank, FAO, IFAD and UNCTAD have taken the lead in the development of guidelines or codes of conduct to govern large-scale FDI in the agricultural sector of developing countries around a set of core principles. UNIDROIT has not yet been formally invited to join this process. The Secretariat submits, however, that through its particular mandate and expertise in the formulation of uniform rules in the area of private law, and the comparative law method it applies in its work, UNIDROIT might have a contribution to make in discrete areas of private law that may be involved in the broader discussion of FDI in the agricultural sector. These areas may include, for instance, private law aspects that have not thus far been dealt with by other private law rule-making agencies (such as property law). Additional areas may include financing and commercial law aspects that come into play in the negotiation and performance of FDI agreements in the agricultural sector. Subject to the approval of the Governing Council, the Secretariat would be ready to explore with the agencies that have taken the lead in the process described here, the extent to which a contribution by UNIDROIT, within the limits of its mandate, might usefully supplement their particular areas of expertise.

44. Independently from a possible involvement of UNIDROIT in the formulation of guidelines for FDI in the rural sector, the Secretariat submits that UNIDROIT might usefully consider the scope for formulating legislative advice aimed at assisting legislators and policy-makers modernise or enhance the domestic legal framework for investment in agricultural production. The general debate on agriculture FDI being, as it is, driven by a particular social and economic international phenomenon, not much attention has been given to another aspect that, at least in theory, should go hand in hand with a discussion on the legal aspects of investment in agricultural production, namely: the extent to which the various fields of private law that affect investment decisions, financing and marketing mechanisms for agricultural commodities in most countries promote sustainable agricultural investment, facilitate the mobilisation of capital for rural enterprises or favour rational and efficient choices for marketing of agricultural commodities.

45. Legal and institutional reforms that improve the creation, perfection and enforcement of security interests are likely to have important long-term benefits for the expansion of term finance, despite the time horizon for implementation. Key measures would include legal and institutional reforms to broaden the range of assets that can be used as collateral, including movable assets such as equipment, livestock, crops, inventory and receivables. A great deal of work has been done

in recent years by various international organisations to assist domestic legislators and policymakers improve the legal framework for secured transactions. Similarly, much valuable work has been done on various aspects of private law that affect the structures and marketing strategies of enterprises operating in the rural sector, either by means of general advice, or in country-specific or regional programmes. Yet the Secretariat is not aware of any international guidance document that would have presented the results of all of those instruments, studies and guidance documents, as they apply in particular to the private law aspects of transactions in the agricultural sector.

46. The preparation of such an instrument, possibly in the form of a legislative guide, in the balanced and non-intrusive way that may be expected of UNIDROIT, might provide a useful addition to the wealth of specific advice already available. The instrument envisaged here should present various options available to countries from different legal traditions and discuss their relative advantages and disadvantages from the point of view of the overall objective of promoting investment in agricultural production and easing access to rural credit.

47. The Governing Council may wish to authorise the Secretariat to continue its preliminary research into agricultural finance as first topic under the general heading “Private Law and Development”, with a view to identifying areas relating to the financing of agricultural investment and production in which UNIDROIT may make a meaningful contribution. It should be understood that the involvement of UNIDROIT should supplement rather than duplicate the work done by other organisations.

48. As a first step to that end, the Secretariat would envisage organising, in cooperation with other international organisations, a colloquium in the first quarter of 2011 on the legal aspects of agricultural financing to canvass the international work done in the area and assess the need for, and desirability of, developing legislative guidance on selected areas of private law that might have an impact on the availability of financing for agricultural production.


60 The FAO Legal Office, for instance, in the series “Legislative Studies”, regularly publishes legal studies on a wide range of legal and regulatory issues affecting infrastructure investment and production, some of which usefully discuss selected topics of private law (such as land tenure and water rights) in the light of the light of FAO policy objectives agreed by the organisations’ member States (see http://www.fao.org/Legal/legstud/list-e.htm).

61 For instance, after having EBRD has funded the implementation of warehouse programmes in the Slovak Republic and Bulgaria, the EBRD approved a Regional Warehouse Receipts Programme in 2000. EBRD mobilised expertise from FAO under the EBRD-FAO Agribusiness Framework Agreement. The experts were asked to review the legislative framework in Russia and assess the feasibility of setting up a workable grain warehouse receipt system (see <http://www.sof.ebrd.com/pubs/funding/tc00o.pdf>, p. 109, 15 March 2010).