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Agribusiness: Global Perspectives

Opportunities for Growth


Introduction

Agribusinesses operate across the world and must have robust and adaptable processes in place to digest and implement the many legal and regulatory initiatives that are employed by governments and international organisations around the globe. These laws and regulations do not always fit in a neat category of "agribusiness", but rather the agribusiness sector is incidentally affected by other, wider, regimes for instance intellectual property and national security. We explore some examples of these in this work and look at how agribusinesses are reacting to them.

Internationally, the main cross-jurisdictional framework within which agribusinesses operate is the WTO agreement on agriculture. While this has provided a degree of certainty, there are some particularly key parts of that framework which struggle to attain full recognition in some jurisdictions. In particular, the parts of that agreement dealing with export restrictions are discussed in detail in our opinion piece *"Getting Food on the Table - Market Volatility and Export Restrictions in the Context of Agribusiness".*

The export restrictions we discuss come at a time when global food security is almost as significant a political and social issue as energy security. A number of factors have contributed to this. These include various recent supply uncertainties (one of the most prominent and recent examples of which is the indirect Ukrainian wheat export limitations implemented in October 2012); the steeply rising demand for protein based agricultural products in developing economies; the increasing demand for bio fuels; and the simple fact of the growing world population. Answers to the questions these problems pose can only truly be answered with global cooperation and internationally applied rules and are the subject of much debate.

We hope you find this publication useful and thought-provoking. Should you have any questions, comments or observations please get in touch with your usual contacts at Clifford Chance or one of our colleagues listed on page 40.

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Making Waves: Tackling Water Scarcity – Water Trading Concepts and Possibilities

The Problem

Concern over water scarcity is not a new topic, but only in the last four or five years has it begun to receive mainstream public and media attention in the way climate change did ten or fifteen years ago.

Water scarcity is being driven by two converging phenomena: growing freshwater use and depletion of usable freshwater resources. Global demand for water used for domestic, agricultural, industrial and energy purposes is reported to have increased by 300% in the last 50 years. Much of the new demand arises from food production with the World Bank estimating that demand for food is likely to rise by 50% by 2030. Larger populations need more food, and more affluent societies are developing greater meat eating habits which use more water. Agricultural crop needs for water are also increasing with the growth of biofuels crops.

This growing need for water has been matched by depleting freshwater resources across the world, in particular groundwater upon which many countries rely for their food irrigation. Climate change is disrupting precipitation patterns which makes rainfall less predictable and more prone to extreme weather, where water cannot easily be captured for use. Water pollution also affects available resources.

Why does it matter?

The most obvious impact of water scarcity is falling productivity for agriculture (and therefore rising food prices), but it can also cause interruption for big business. For example, a US power generator had to stop power production temporarily at some plants in 2008 after a drought caused low water levels.

In addition to affecting lives and business operations, there are fears that water scarcity will lead more often to security concerns within or between countries, and even trigger armed conflict. Such concerns are not new and often revolve around treaties used to determine the usage of water from cross-border rivers. Egypt has an age-old dispute with its neighbours about how the waters of the River Nile are used, with Egypt currently refusing to sign a new treaty which would allow those neighbours greater use rights. There are tensions in Pakistan and India over the alleged depletion of waters in Kashmir controlled under the Indus Treaty, with Pakistan in particular claiming that Indian infrastructure projects such as hydroelectric dams are affecting its access to water.

Solutions

Increasing supply and reducing demand

A traditional way of increasing water supply is to extend and improve infrastructure: reservoirs are built to catch more rainfall, rivers are dammed to capture more of the flow; ancient pipe-work is modernised to reduce leakage. In addition to improving infrastructure, desalination projects in many countries aim to create new sources of water. However, the expense of these projects, their effects on neighbours (as in the examples mentioned above) and the impacts of climate change will mean that these methods alone are unlikely to be sufficient to address water scarcity.

Matching supply and demand will therefore require more effort on the demand side. There are already a wide array of techniques used to reduce demand from domestic and commercial customers. These include, for example, applying water–saving technology in irrigation projects (e.g. drip irrigation) or in a domestic context, placing technical requirements on design of water-using appliances. The European Commission is currently considering how building standards can be introduced to ensure structures are more water efficient.

"Global demand for water is reported to have increased by 300% in the last 50 years."

Supply/Demand Solutions

1. Improve existing infrastructure
2. Expand infrastructure
3. Reduce water use

One of the major issues identified in hampering the efficient use of water is its artificially low price. With metering, customers often pay for the actual amount of water they use, but this tends not to include the full external costs of water supply. For example, major national infrastructure costs of creating dams and pipelines or the ecological cost of extraction are often not factored into the cost of water. This acts as a disincentive for water users to be efficient in their use.

Water Trading

(a) What is it?

Water trading systems are an increasingly recognised way of encouraging efficient water use in a scarce water environment. They can also help allocate resources between competing demands. This could be competition between different uses, e.g. between crops and energy use (an example is Alberta's proposed Oil Sands extraction schemes which would compete for water with local agriculture); or between different crops e.g. where crops are grown for food or for biofuel purposes.

Essentially water trading is a structure for buying and selling entitlements to use water. The philosophy behind it, like in any market, is that water will be allocated to the person who can make the most economically productive use of the water and is therefore willing to pay more for it from an irrigation perspective, for example, this should lead to more efficient food production as water use is applied to higher value food products.

(b) Australian Case Study

Australia boasts one of the most advanced water trading systems which has been in existence for around twenty years and is still developing. The system operates, in basic terms, as follows:

- In order to establish a water trading market, rights to use water ("water rights") need to be separated from the rights to land (such as riparian rights where the owner of land is entitled to the water flowing through it). In Australia, this has been done by abolishing "riparian" rights and transferring them into tradeable water entitlements. This process of "unbundling" still continues in various states.
- A cap is placed on additional water extraction and water users are then required to purchase water entitlements from other users who do not need their full entitlement. The trade can be of permanent entitlements or temporary duration rights (called allocations).
- An entitlement will comprise a right to extract a defined percentage of available water volumes per year. Carryover rights will allow limited banking of rights to the following "water year". Unlike a carbon allowance, however, a water right may only give a right to access water where it is available (for instance, if a river has sufficient flow) and therefore rights are classified as to the source's reliability.
- There is no single water exchange, and the market functions through private trades, using brokers, water exchanges or even message boards. Each Australian state has its own water trading rules.

Australian Results

The domestic market reportedly increased to around AU$3 billion by 2010. The Australian government national water commission reported that whilst the value of the market appeared to have waived to Au $1.5 billion in 2011, volumes of water traded continued to increase.

According to the National Water Commission - Australian Water Markets Report in 2008–2009, trading in the MDB has provided vast economic benefits to the local region and given irrigators a greater security of supply and ability to deal with drought conditions.

In theory, city dwellers in one region could buy water entitlements from an owner in another region. The need to physically transfer the water, however, has been a barrier to this type of trade. The expense of transferring water through pipelines or tankers means that trading occurs mainly within areas that are hydrologically linked, such as the Murray-Darling Basin in Australia ("MDB"). So for example an extraction from one end of an aquifer can be traded for an extraction at the other end. The Murray-Darling Basin in Australia, extends over 3 states and receives 90% of the region's water. This area has seen 70-80% of Australia's total water trades.

Australia combines this trading system with a focus on enhancing the sustainability of water resources. For example, a regulatory basin management plan will soon be put in place for the MDB which will provide for integrated management of water resources including ensuring quality and quantity of water (including environmental sustainability limits on extraction, although this has proved to be fiercely controversial, fitting the environmental lobby against farming communities). In addition, the federal government and state governments purchase entitlements to increase water flows for environmental sustainability reasons.

(c) Widening of Water Trading

Can the Australian success be replicated on an international scale? Although interest in water trading concepts is increasing, there are significant barriers to internationalisation, including:

- The high cost of water transfer (for example, through pipelines or in tankers), limiting the ability to trade water beyond hydrological boundaries. Australia, however, is developing a wider inter-state water grid which is expected to make the market more robust.
- The variety of trading rules between states. This has led, for example, to the imposition of controversial caps in Australia on trading outside irrigation districts (for example 4% in Victoria). Such caps were ostensibly for water security purposes but commentators complain that this unduly restricts trading and market growth.
- The complexity and bureaucracy of the trading system, whereby most trades need the approval of a trade approval authority.
- The rights being traded relate only to a percentage of available water rather than an actual volume. This makes water and water rights a potentially problematic type of commodity to trade more widely (and very different from carbon which is the same no matter where it is emitted).

Whilst water trading is on the agenda at an international level, these issues make it unlikely that wide-spread physical water trading systems will ever develop beyond a national level and are likely to be based on schemes controlling defined water catchment areas. It seems probable, however, that more national and regional schemes will be adopted over time (for example the UK is seeking to introduce formal water trading between water suppliers). These schemes will need to be able to adapt to changing weather patterns as well as changes to how we use water.

Virtual Water Trading

Other possible solutions on the table include international "virtual water trading". Virtual water use refers to the concept that water is not only used directly in products and services but is also imbedded throughout the supply chain in any product that is manufactured, imported or exported. The idea of a national "water footprint" could therefore be used to create a global system of virtual water trading. A nation's footprint would be the volume of water used in the country added to the net import of virtual water to that country.

A proposal for an international system of virtual water trading would operate by nation states being given permits based on a "reasonable share" of the world's water resources linked to their water footprint. Such permits could be traded on the basis of an international protocol such as the Kyoto Protocol on carbon emissions. There are many political and sovereignty issues involved in establishing such a system, in particular over the question of "how much water should a state be entitled to?". A suggested alternative to the "reasonable share" approach could be reduction targets based on the water footprint in a specified reference period. This reduction target approach has even greater resemblance to the Kyoto Protocol (with its historical business model premise) and seems more likely to lead to a workable international agreement as a result. Whilst these ideas are being discussed more and more seriously, it looks unlikely that we will see an international agreement on a global water market in the near future.

Alternatives

Other suggested possibilities are:

- A more formal and universal approach to water pricing. This would ensure that all consumers (domestic, agricultural and industrial) are made to bear the full costs of the water they consume, including external costs like environmental degradation (that is to say a form of "polluter pays" approach). Such costs would also deal with any distortions caused by subsidies; for example, subsidies to agricultural businesses which contribute to low value crops being grown in areas with significant water scarcity. It has been suggested that an international protocol in the UN sphere be put in place to achieve this. Water pricing has its own political difficulties given the position of water as a basic human need and the challenge of designing a pricing approach for areas affected by poverty.
- A water labelling system (similar to the energy efficiency labelling systems seen on electrical products in the EU) to improve transparency of water impacts on products and services.

Conclusions

Like climate change, water scarcity is emerging as one of the most significant global challenges of our age. The challenges of addressing water scarcity at an international level are both technically and politically significant. As with climate action, a plethora of approaches will no doubt need to be implemented: from increased infrastructure, to water efficiency policies, through to possible international pricing and trading initiatives (although these international projects will be a longer term vision). Regulation of water use will almost certainly increase, along with more in depth scrutiny by stakeholders and NGOs on corporate water use.

Agribusinesses will be a central focus in these debates given their global footprints and fundamental reliance on freshwater for their operations, either directly or with the products they trade. They will be subject to new regulatory schemes as they develop over time. Agribusiness therefore has much to contribute in the debate to help design approaches that are both sustainable and equitable, and also helping to future-proof a profitable business. A good first step on the road to future-proofing will be to consider carrying out a complete corporate water footprint analysis to see how much a business relies on water throughout its operations and supply chain. This will assist in identifying and planning for an increasingly water-constrained world.

Head Starts not False Starts – Pre-Marketing for Plant Protection Products – European Regulation (EC) No 1107/2009

Why pre-marketing?

The successful marketing of plant protection products begins before they are even authorised for sale. Information on products still in development is often sent to interested parties prior to authorisation being issued.

The purpose of providing this information can vary enormously, depending on how far development of the product has progressed and who the information is being given to. It can give potential buyers the chance to hear about upcoming product launches or allow potential investors to learn about a particular company's development pipeline. It can allow the exchange of information and ideas with relevant university and research institute experts at an early stage in the development process for a specific product. In practice, these different scenarios and activities are generally referred to simply as "pre-marketing", but this does not mean that they always involve "advertising" in the legal sense. It is an essential tool for developing and marketing a product already at an early stage.

"Pre-marketing is an essential tool for developing and marketing a product already at an early stage."

Previous European Legal Framework

Until recently, there have not been any specific provisions on the legality of pre-marketing for plant protection products on a European level. The only provisions which have been applicable are principles and advertising standards set out in EU Directive 2006/114/EC concerning misleading and comparative advertising and Directive 2005/29/EC concerning unfair commercial practices. These both state that any advertising giving the misleading impression that a product requiring authorisation has already been authorised is illegal.

It is not the case, however, that all pre-marketing automatically creates this misleading impression, since the context and content can be used to ensure that there is no risk of confusion over whether an authorisation has been issued. Some member states including the United Kingdom, France and the Netherlands have introduced their own national provisions banning the advertising of plant protection products which have not yet been authorised. Countries such as Germany, Spain and Italy have not introduced any such ban.

New European ban on advertising non-authorised plant protection products

The situation has changed with the entry into force of Regulation (EC) No. 1107/2009 concerning the placing of plant protection products on the market (the "Regulation"). This Regulation has been in effect in all EU member states since 14 June 2011. It contains the first harmonised EU provisions on the advertising of plant protection products (Art. 66 of the Regulation). The provisions are particularly strict since they state that plant protection products may not be advertised at all if they are yet to be authorised (Art. 66 para 1 sentence 1), although the precise scope of this ban still needs to be clarified.

These provisions represent uncharted legal territory for many companies, public authorities and courts, which makes pre-marketing compliance issues particularly tricky. The precise extent to which Art. 66 para 1 sentence 1 of the Regulation places additional limitations on the pre-marketing of plant protection products is therefore crucial for managing pre-marketing compliance issues.

Nature of the ban

The impact of the ban on advertising non-authorised plant protection products differs according to the legal perspective from which it is viewed:

The "misleading ban" reading

On one reading, Art. 66 para 1 sentence 1 of the Regulation is based on the legal assumption that advertising for non-authorised plant protection products is typically misleading. From this perspective, it would amount to a *special ban of misleading advertising*, allowing for the statutory assumption of the advertising being misleading to be disproved in practice.

It is obviously crucial which of these two interpretations is used by the authorities, courts and market players. While the "misleading ban" reading allows the party concerned to continue advertising non-authorised plant protection products if it is made sufficiently clear that they are not yet authorised for sale, the "definitive ban" reading prohibits any such advertising *per se*, regardless of whether it is misleading.

Taking the wording of Art. 66 para 1 sentence 1 at face value suggests the "definitive ban" is the correct reading. There is, however, nothing to suggest that it was the legislator's intention to impose

The "definitive ban" reading

The provision could alternatively be regarded as a definitive ban on advertising non-authorised plant protection products, irrespective of whether the advertising would actually cause a misleading impression in practice.

such a wide-ranging restriction on companies' freedom to advertise, particularly given that this is one of the basic freedoms the EU promises to protect. In fact, no. 43 of the Regulation's recitals expressly states that the aim and purpose of the new requirements is to protect users and the public from misleading advertising. It would be a clear contravention of the purpose of the Regulation if it also applied to advertising which is not in any way misleading.

Scope of the ban

Irrespective of the nature of the ban, Art. 66 para 1 sentence 1 of the Regulation only applies if the advertising in question relates to non-authorised plant protection products. This means that the requirements of the provision do not apply to all information issued or published by manufacturers of those products, but only to advertising measures. Art. 3 no. 31 of the Regulation sets out which particular measures are deemed to constitute "advertising", with this definition consisting of four elements – the nature of the advertising, the intended recipient, the medium used and the subject of the advertising.

(a) What are relevant advertising measures?

The key determinant of whether a specific type of information/disclosure infringes the ban is whether it can be classified as advertising within the meaning of that provision ("shall not be advertised").

Given that almost any type of information can be deemed to have some form of advertising effect, it is important to make a distinction between simple information/disclosure and advertising. "Advertising" as defined in Art. 3 no. 31 of the Regulation is any means intended to promote or encourage the sale or use of plant protection products. In order for information to be regarded as advertising it therefore needs to be considered to constitute information for the purpose of promoting or encouraging the sale or use of plant protection products. In other words, it needs to include the intention of promoting or encouraging sales or usage. If this intention exists, the information issued/published is considered to constitute advertising within the meaning of the Regulation and, if not, it is merely regarded as having an informative purpose.

The difficulty lies in identifying whether the aforementioned intention exists. Objective criteria need to be applied in view of the fact that such intention is an inherent aspect of the information, the existence of which can only be determined on the basis of external indicators. These criteria are then used as part of the assessment of whether the party concerned had a subjective intention to advertise plant protection products. The most important of these objective criteria are (1) the language used, (2) the content, (3) the intended recipients, (4) the "direction of communication", that is to say whether a company issues information of its own volition or at the request of another party, and (5) the identity/characteristics of the party issuing the information.

What has proved slightly more difficult is determining the relationship between the individual criteria and how much weight to assign to each one:

- In the event that typical advertising language is used, rather than simply providing factual information, this would suggest that the aforementioned intention to advertise exists. Conversely, if the language used is generally factual in nature, this supports the assumption that the information is simply informative and contains no intention to advertise.
- The actual content of the information is also significant. A detailed, objective description of product features is contraindicative of advertising, with subjective content and selective descriptions suggesting that the text is intended as advertising material.
- The intended recipients of the information may also indicate whether there is any intention to advertise. If the information is aimed at recipients who would typically buy a particular product, it is likely to be advertising, but this is not the case if it is aimed at parties that are not generally considered to be potential customers, such as journalists or academics.
- The direction of communication is also a factor, as indicated by Art. 86 para 2 of Directive 2001/83/EC. It is important to make a distinction between those cases where companies actively approach recipients with information ("push situations") and those where recipients request the information themselves ("pull situations").
- Another key feature which often arises in the case law in this area is the identity/characteristics of the party issuing the information. Case law on this issue in the pharmaceuticals sector has tended to view any information issued by manufacturers as being advertising. This kind of blanket assumption would be a clear infringement of the EU's legal requirement to make a distinction between advertising and straightforward information. The European Court of Justice recently ruled that information provided by independent third parties can also be regarded as advertising in the aforementioned sense, which is only logical given that any party may be subjectively regarded as having the intention to promote or encourage

sales of a particular product. This also means, however, that the assumption cannot automatically be made that companies intend to advertise whenever they issue any kind of information. It is true that companies have a fundamental interest in selling their products, but a distinction still needs to be made between information for advertising purposes and information primarily serving other ends.

(b) Who are the relevant addressees?

Art. 3 no. 31 of the Regulation sets out those addressees for whom receipt of information from a company may constitute advertising. Information provided to the holder of the authorisation, any party distributing/marketing the plant protection product or any of their representative, along with any parties involved in the distribution/marketing of such products, cannot realistically be viewed as advertising. This type of distinction means that only those advertising measures aimed at the general public or specific users (for example, farmers) are covered by Art. 66 para 1 sentence 1 of the Regulation. Information provided to merchants and retailers receiving deliveries direct from the manufacturer cannot be considered to constitute advertising as they are not users of plant protection products, but merely part of the distribution network. No. 43 of the Regulation's recitals supports this interpretation by stating that the (sole) intention of Art. 66 of the Regulation is to ensure that advertisements do not mislead users of plant protection products or the public. Information provided to merchants and retailers is not aimed at either users or the public.

(c) What is the advertising medium?

Art. 3 no. 31 of the Regulation states that only printed information or information distributed by electronic means may be regarded as advertising. No further details of this restriction are given in the Regulation's recitals, but it is likely to be based on the correct assumption that information provided verbally is not of significant practical relevance and does not involve the same risks as printed information or information sent electronically, of which there is a concrete record and which can be passed on to other parties.

(d) What products are being advertised?

Not all information which may be regarded as advertising under the aforementioned criteria is therefore automatically covered by Art. 66 para 1 sentence 1 of the Regulation. The provision actually states that the advertising ban only relates to non-authorised plant protection products. It is therefore advisable for companies not to make reference to specific products in order to ensure that any general advertising does not fall within the scope of the aforementioned provision. This also helps ensure that information on issues such as specific pests and products to combat them are not automatically covered by the provision. The question of whether information includes adequate reference to a particular product or products (as opposed to company brand advertising) depends on whether the information specifically or implicitly refers to a particular plant protection product. This is generally deemed to be the case if a particular product is named specifically, but is more difficult to determine if there is no such specific reference. This requires a more graduated approach, based on various factors such as the level of understanding, prior knowledge and viewpoint of the person at whom the advertising is directed.

Another important feature of Art. 66 para 1 sentence 1 of the Regulation is that it relates solely to plant protection products. The ban does not therefore cover advertising for any non-authorised active ingredients used in such products. In view of the fact that the provision makes an explicit distinction between the authorisation of active ingredients and the authorisation of plant protection measures, this was clearly a deliberate decision by the EU's legislative authorities. Any interpretation or application of Art. 66 para 1 sentence 1 of the Regulation whereby reference to a specific active ingredient is automatically considered to be a specific reference to a plant protection product would be an infringement of this legal construction.

In order to ensure that the advertising ban for non-authorised plant protection products is not reinterpreted as a ban on advertising the non-authorised active ingredients used in those products, it should be examined in each case whether simply naming the relevant ingredient/substance constitutes adequate reference to a specific plan protection product.

Penalties

Art. 72 of the Regulation states that member states shall lay down their own rules on effective, proportionate and dissuasive penalties in order to enforce the requirements of the Regulation. The Regulation itself does not make any provision for imposing penalties, as is standard practice in EU regulations, and it therefore falls to national legislatures to provide for fines and/or criminal offences.

Summary and Conclusion

The Regulation came into force on 14 June 2011 and Art. 66 thereof contains advertising requirements for plant protection products. At first glance, the biggest change in these requirements is that Art. 66 para 1 sentence 1 of the Regulation contains a ban on advertising non-authorised plant protection products. This ban therefore also relates to pre-marketing activities, which have become standard practice and are an absolute necessity in many cases. With there already being EU provisions with comparable wording for pharmaceutical products, and with these having been interpreted by courts and public authorities as definitive ban, it would be easy to make the mistake of interpreting Art. 66 para 1 sentence 1 of the Regulation in the same way. However, the advertising ban set out in the Regulation has a different aim (as provided for in its recitals), namely to prevent misleading advertising and to establish grounds for assuming that such misleading advertising exists. Given this, the ban does not apply in those cases where it is made sufficiently clear that the plant protection product being advertised has yet to be authorised.

The ban only relates to those activities which are defined as advertising within the meaning of the provision. The first distinction to be made in terms of advertising activities is between information which is purely informative and information with an advertising function. The crucial aspect in terms of both the Regulation and the relevant case law is whether the information is intended to promote or encourage the sale or use of plant protection products, i.e. whether it includes the intention of promoting or encouraging sales or usage. The existence of this subjective characteristic can only be determined on the basis of external indicators, including the language used, the content, the intended recipient and the direction of communication. The source of the information, e.g. the manufacturer itself or a third party, is less important. If the information is provided by the manufacturer itself, this does not necessarily mean that such a subjective intention exists.

Another unique feature of the advertising requirements for plant protection products is that Art. 3 no. 31 of the Regulation limits those people who advertising may be aimed at. Information can only be regarded as advertising if it is aimed at the users of the specific plant protection product. This is justified on the basis that the sole aim of the new requirements is to protect users and the public in general from misleading advertising. Another unique provision is that only advertising using certain media is covered by the ban. Art. 3 no. 31 of the Regulation states that only information distributed using print or electronic media is subject to the ban provided for in Art. 66 para 1 of the Regulation.

The ban on advertising non-authorised plant protection products only covers advertising relating to a particular product. This therefore only covers product advertising and not general company brand advertising. The assessment of whether there is sufficient reference to a particular product depends on whether it is expressly or implicitly clear from the advertising that it relates to that product. This is easy to determine if the advertising refers to the actual name of a specific plant protection product, but is more difficult if it does not refer to the product by name and only mentions a certain active ingredient. In order to support the aim of the ban, which is restricted to plant protection products under Art. 66 para 1 sentence 1 of the Regulation, and is not intended to cover active ingredients, there are stringent requirements for references to a product by means of an active ingredient.

There are not currently any provisions for penalties to be imposed for infringements of the ban, but the Regulation requires member states to implement national provisions for imposing such penalties. In order to ensure compliance regarding pre-marketing, it is therefore advisable to design/structure the advertising so that it is not covered by all of the requirements of the provision. This may be done by ensuring that no advertising language is used, or by selecting specific recipients or advertising media.

Getting Food on the Table – Market Volatility and Export Restrictions in the Context of Agribusiness

Introduction

In the wake of the 2007-2008 food price crisis and the food price spike in 2010-2011, the World Trade Organisation ("WTO") rules have been the subject of much criticism over a perceived inability to curb the use of export restrictions which distort markets and impact on agricultural commodity prices.

At times of extreme food price volatility, many governments impose trade restrictions in an attempt to insulate their domestic consumers. Protective trade restrictions, however, tend to do more harm than good by introducing a multiplier effect which exacerbates volatility and pushes food prices even higher. This was experienced with the food price crisis of 2007-2008 and food price spike in 2010-2011.

Price volatility within international agriculture markets poses a major threat to food security. In the short term, prices of staple goods may rise to unaffordable levels and threaten food supply, particularly for the world's poorest. In the long run, price instability will undermine investor confidence in international agriculture markets and deter the investment into farming and agribusiness necessary to ensure that, as the world population continues to grow, so do gains in agricultural production to meet increasing consumption demands.

With global food security potentially at risk where these markets do not function properly, the importance of international agreement and coordination on agricultural and trade policies is more crucial than ever. A look at policy responses by WTO members to the recent agricultural commodity price spikes suggests that, in the absence of meaningful penalties, existing WTO rules may not provide a strong enough framework for discouraging the use of damaging trade restrictions. It is also clear, however, that the international community has begun to realise that the realities of today's globalised agribusiness sector demand a more holistic and coordinated approach to trade policies if market stability and global food security are to be achievable.

Food security and market volatility

Food security

Global trade in agricultural commodities is an important focal point for international policy discussions because of the potential consequences to food security when supplies diminish or other trade disruptions occur. There are growing concerns over future sustainability of agriculture for reasons including the detrimental effects of increasingly adverse weather on growing conditions and the challenges this will present to global supply levels, and, perhaps most significantly, the significant dearth of the necessary resources required to meet our future consumption needs.

The Food and Agriculture Organisation of the United Nations ("FAO") estimates that agricultural production will need to increase by 60% globally and nearly 77% in developing countries by 2050 to cope with the food consumption needs of a larger, more urban and wealthier population. Increased demand for feedstock coming from the growing biofuels sector will only add to this already significant growth requirement.

Overall, production gains in agriculture have kept pace with demand growth over time. Progress, however, has been uneven and growth in global agricultural production is expected to slow in the coming decade as a result of growing resource constraints, environmental pressures and higher costs for some inputs. In this context, investment in agribusiness will be a crucial factor in achieving necessary increases to agricultural productivity. One of the greatest threats to future agriculture investment and expansion, however, lies in the market volatility that agricultural markets have historically been prone to.

> "Overall, production gains in agriculture have kept pace with demand growth over time."

Price volatility and market forces

Agricultural markets are characterised by greater price variability than most other markets as price movements are driven by a multitude of external factors such as weather, energy prices and macroeconomic conditions. This price instability is not in itself harmful; where variability is seasonal or occurs with well-anticipated patterns, market participants are able to undertake appropriate risk management. However, throughout the past 5 years, price movements in agricultural commodities have been dramatic, unpredictable and extremely volatile.

According to the International Food Policy Research Institute ("IFPRI"), today's global agricultural markets are highly concentrated, lack in supply stocks, and suffer from inadequate information resources. These characteristics interact to elicit extreme market reactions to supply shocks (i.e. due to poor harvests or reduced trading).

(a) Market challenges

Supply and demand factors in agricultural markets are constrained by natural growing cycles and relatively inflexible consumption needs. The supply of main staple commodities – rice, maize, wheat and soybeans – is either highly concentrated among a few major exporters, or else spread thinly among producers who export only a small share of that supply. The market is therefore less able to cope with market challenges or absorb shocks effectively (i.e. through changes to production or consumption), causing higher prices and price volatility as witnessed during the recent food price crises.

High and volatile prices reduce purchasing power for consumers and can pose a significant threat to food security. For the world's poorest – who spend up to three-quarters of their total income on basic foodstuffs – the prices of staple products rise to unaffordable levels and can lead to starvation and malnutrition. These conditions also challenge the resilience of farming operations, as producers are unable to plan effectively for their businesses. Price spikes in animal feed commodities can result in farmers being forced to cull livestock if they cannot afford feed prices, leading to further food shortages.

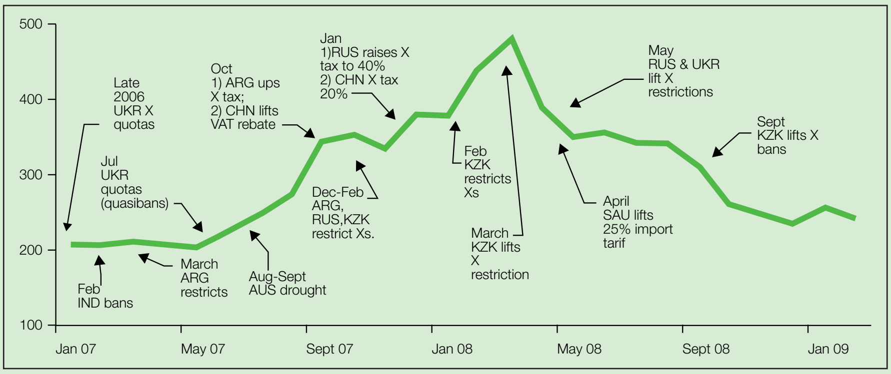
(b) Trade restrictions and the multiplier effect

Governments are particularly sensitive to high prices and volatility in the global market because of the impact these could have on pricing, access to and availability of certain agricultural commodities on their domestic markets. When global markets experience a supply or price shock, governments may, for a variety of reasons including insulation of their domestic markets, protection of national food stocks, political motivations and government finance (export taxes), choose to impose trade restrictions on the import or export of food.

Trade restrictions, and export restrictions in particular, introduce uncertainty and reduce transparency in trade. The resulting market conditions discourage investment into agriculture, and have also been found to aggravate price volatility on the global market. Export restrictions can therefore act both as a key contributor and reactionary response to high and volatile food prices, feeding into a multiplier effect.

Case Study : The Multiplier Effect

The multiplier effect of export restrictions on food prices was seen during the 2007-2008 food price crisis, when a series of trade restrictions contributed to grain prices hitting record levels. The timeline below shows the increase in global wheat prices (shown in US$/tonne) throughout 2007 and early 2008, noting the various supply shocks and trade restrictions associated with sharp price increases.



Source: Food and Agriculture Organization of the United Nations, 2011, Ramesh Sharma, Food Export Restrictions: Review of the 2007-2010 Experience and Considerations for Disciplining Restrictive Measures, http://www.fao.org/fileadmin/templates/est/PUBLICATIONS/Comm_Working_Papers/EST-WP32.pdf.

If a food shock drives up prices in world markets and countries respond by increasing their own export restrictions to protect their domestic consumers, this in turn pushes prices up further, feeding into a multiplier process and exacerbating the initial effect of the shock. Furthermore, once one government initiates the introduction of export restrictions, there can be a domino market closing effect: one restriction bringing on another as the world starts to anticipate a global food shortage.

(c) The need for reliable market information

Reliable access to accurate information is crucial to the functioning of agricultural markets, as market data will inform the policy measures and trading decisions that feedback to either ease or exacerbate price volatility.

Market players must rely on information about crop conditions, available stock levels, future yield projections and market activity to assess their risk and take responsible and informed policy and trading decisions. A lack of up-to-date information, or information that is inconsistent, unreliable or inaccurate, creates uncertainty within the market. Equally, the imposition of trade restrictions can distort the accuracy or meaningfulness of the information that is available. These issues can lead to uncoordinated and improper policy responses, or to surges or slow-downs in trading activity when information becomes available, all of which contribute to volatile price movements.

"The unique challenges present in agricultural markets mean that grain stock levels have a crucial influence on reactions to shocks within the market."

The unique challenges present in agricultural markets mean that grain stock levels have a crucial influence on reactions to shocks within the market. Reserve stocks must be sufficiently plentiful to provide an emergency supply for consumption or trade requirements to keep food security and other supply-related crises at bay. Where reserve stocks are low, however – as currently, with cereal stocks at historically low levels, and as was the case during both the 2007-2008 and 2010-2011 food price crises – the immediacy of supply-related concerns can provoke extreme and protectionist reactions from market players that distort market fundamentals and drive price volatility. For example, when the US Department of Agriculture released its quarterly inventory data at the end of September 2012 and statistics revealed that grain inventories well below anticipated levels, a rush of buying orders caused corn prices (which had been declining) to rise by nearly 6% and wheat prices to jump 5.3% on the day. Accurate and current information about reserve stocks, then, is a crucial requirement for market stability.

WTO rules on export restrictions

The WTO rules governing use of export restrictions prohibit members from introducing export restrictions except in certain critical circumstances. Adherence to these rules would limit the trade policy responses available to WTO members and guard against the detrimental impact of the multiplier effect.

General Agreement on Tariffs and Trade (GATT)

Article XI

1. *No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.*
2. *The provisions of paragraph 1 of this Article shall not extend to the following:*
   a. *Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party*

Agreement on Agriculture

Article XII

Where any Member institutes any new export prohibition or restriction on foodstuffs in accordance with paragraph 2(a) of Article XI of GATT 1994, the Member shall observe the following provisions:

(i) *give due consideration to the effects of such prohibition or restriction on importing Members' food security;*

(ii) *give notice in writing, as far in advance as practicable to the Committee on Agriculture comprising such information as the nature and the duration of such measure; and*

(iii) *consult, upon request with any other WTO member having a substantial interest as an importer with respect to any matter related to the measure in question.*

Criticisms of the WTO regime

Despite these rules being in place, many countries have continued to introduce trade restrictions in response to agricultural commodity price shocks and during times of extreme volatility in the international agricultural markets.

Policy responses during the recent food price crises

In 2007, when poor weather conditions cut harvests in several countries, food prices increased dramatically as a result of the shortened supply. In response, more than 30 countries imposed quantitative export restrictions, export taxes, prohibitions and price controls in an effort to maintain an adequate domestic supply, and in some cases to contain growing public discontent over the increase in food prices.

At the request of the G20 summit, a policy report was prepared by the FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI and the UN HLTF titled "Price Volatility in Food and Agricultural Markets: Policy Responses" (the "Joint Policy Report"). The report states that:

"during the 2007-2008 period, some policy measures put in place by a number of governments contributed directly and indirectly to the crisis (export restrictions, hoarding), increasing the amplitude of price movements and in some cases provoking price increases that were otherwise inexplicable in terms of the market fundamentals. Inappropriate policy responses also contributed to volatility and could continue to do so unless the international community is able to take steps to avoid such actions."

When food prices rose sharply once again in 2010 after similar widespread crop failures, again, export bans, shipment quotas, and export taxes were introduced by countries looking to insulate their domestic markets. Although the extent of intervening measures taken in response to this price spike was slightly more muted, commentators argued that this was yet another example of the WTO rules allowing countries to resort to export restrictions too easily, without regard for the detrimental effects on the international agricultural markets, and providing little recourse for those adversely affected by the restrictions.

Limitations of the WTO rules

The restrictions imposed during the 2007-2008 and 2010-2011 food price crises caused extensive trade disruption and other repercussions to the global agricultural markets, and yet no formal WTO complaints were made against members who imposed them.

A major criticism of the GATT has been that it lacks definitions for what constitutes "temporary", "critical" or a "shortage", therefore making it difficult for any adversely affected country to raise the concern that an export ban is not justifiable under Article XI:2(a). Similarly, the provisions in the Agreement on Agriculture which attempt to refine the GATT Article XI:2(a) conditions by introducing a notification procedure also remain undefined, leaving adversely affected countries unable to effectively argue that such a procedure was not followed.

The main limitation of the WTO regime, however, seems to be a lack of meaningful penalties that could be levied against non-compliant behaviour. This serves to diminish the effectiveness of the regulations at discouraging or curtailing members' non-compliant use of export restrictions.

Alternative views on WTO rules

The WTO rules have so far been ineffective at providing the global community with adequate protection against the use of export restrictions on agricultural commodities. However, an argument was recently put forward in a position paper for the International Food & Agricultural Trade Policy Council that, "the WTO disciplines properly interpreted are not as meaningless or ineffective as the conventional wisdom has suggested". The position paper, titled "*Agricultural Export Restrictions and International Trade Law: A Way Forward*", analysed the implications coming out of a recent WTO dispute over GATT export restrictions and also considered the applicability of the WTO's General Agreement on Trade in Services (GATS) regulations to global agribusiness services.

China – Raw Materials: illustrating the GATT exceptions

Although not an agricultural case, the WTO's recent China – Raw Materials case may provide useful guidance for interpreting ambiguities in the conditions of the GATT Article XI:2(a) and in the Agreement on Agriculture.

The WTO's Appellate Body considered whether China's export restrictions on the mineral beauxite met conditions in Articles XI:2(a) or XX(g) of the GATT, providing a new framework for interpreting these provisions. Article XI:2(a) was said to be relevant to measures applied to bridge a passing need for relief in extraordinary conditions; Article XX(g), on the other hand, applies to trade measures imposed to deal with conserving finite resources (which could conceivably constitute a foodstuff), rather to alleviate an immediate shortage. The Appellate Board provided some clarification in relation to Article XI:2(a), stating that "temporarily" indicated a measure "of limited duration and not indefinite", and that "critical shortages" refers to deficiencies in quantity that are crucial, not merely in short supply.

The Appellate Board determined that any trade measures contemplated under Article XX(g) should "work together with restrictions on domestic production or consumption". Invoking this exception therefore requires that a balance is struck between a member's domestic conditions and the prevailing global conditions. Article XX further demands that trade measures cannot arbitrarily discriminate between other members. As discrimination can be either positive or negative, any member wishing to validly invoke Article XX of the GATT in relation to a trade restriction must consider the possible effects of that restriction on all other WTO members, and arguably provides a reference point for the "due consideration" required under the Agreement on Agriculture.

Case Study: WTO – China Raw Materials case (2012)

- China put in place export restrictions on a variety of raw materials used as inputs in the steel, aluminium, and chemicals industries
- Complainants – the United States, the European Union, and Mexico – argued that the export restrictions not only made it more expensive for foreign manufacturers to obtain the raw materials they need, but also artificially lowered input costs for competing Chinese producers
- China argued that its restrictions were justified under Article XI:2(a) or Article XX of the GATT
- The WTO Appellate Body found that China's export restrictions on these raw materials did not meet necessary conditions and were therefore in violation of WTO trade rules

GATS Article XVII: protecting global agribusiness services

A significant portion of agricultural trade takes place through global agribusinesses that contract with major producers in exporting countries to sell and/or distribute their products to purchasers around the globe. These agribusinesses facilitate international trade in agricultural commodities by providing intermediary services both to the producers in exporting countries and to importing consumers. Global agribusinesses therefore unquestionably provide "services" within the meaning of GATS (i.e. from the territory of one WTO member into the territory of any other member).

Export restrictions and other trade measures affect these service providers by interrupting supply, increasing transaction costs, and disrupting the flow of trade along distribution networks.

Case Study: NAFTA – Cargill Inc. v. The United Mexican States

- Cargill, an American company, claimed that a Mexican tax on high fructose corn syrup was adversely impacting Cargill's investments in the industry in Mexico
- NAFTA requires that the parties extend fair and equitable treatment to all trading partners
- Cargill alleged that Mexico's import tax and permit system were protectionist policies aimed at protecting Mexico's domestic sugar producers
- The NAFTA tribunal found that the measures were in violation of the national equitable treatment obligation as "measures affecting an investment"
- The tribunal found that Mexican trade restrictions provided an advantage to Mexican sugar producers, to the detriment of Cargill's investment in that market

When an export ban is introduced, a *force majeure* clause in most commercial supply contracts would render those supply obligations unenforceable, in effect forcing the distributor agribusiness to seek out alternative supplies in the costly and volatile marketplace.

Further, insofar as a global agribusiness may compete with domestic suppliers in a given jurisdiction, barriers or tariffs applied to international trade will clearly advantage a domestic supplier who is not subject to such measures. Where trade restrictions have the effect of advantaging domestic service providers over their foreign competitors, a WTO member could arguably be in violation of its obligation under Article XVII of the GATS to "accord to services and service suppliers of any other member, in respect of all measures affecting the supply of services, treatment no less favourable than it accords to its own like services and service suppliers."

Providing a case in point, a recent judgment was given under the North American Free Trade Agreement (NAFTA) in favour of global agri-food supplier Cargill Inc when Mexican trade restrictions on high-fructose corn syrup were deemed to disadvantage Cargill against domestic producers.

NAFTA: a model for meaningful penalties?

If the alternative interpretations of WTO rules suggested in the preceding sections were to be formally adopted, the result would be clearer, more easily enforced GATT rules, and a second line of recourse for global agricultural service providers. However, the fact remains that any resulting disputes would still be dealt with through the WTO's dispute settlement process, which aims to achieve compliance with WTO rules rather than to compensate those adversely affected by non-compliance.

The WTO disciplinary bodies cannot issue penalties to member countries because they do not have the power to impose new obligations on members; these bodies can therefore only take steps to secure compliance with existing obligations. If at the end of the lengthy dispute settlement process a member continues to maintain non-compliant policies, the WTO may authorise complaining members to erect their own trade barriers against the non-compliant member, to put them on equal footing until compliance is achieved.

Accordingly, the WTO dispute settlement process cannot address the ancillary issues arising from trade restrictions on agricultural commodities. First, the WTO's dispute settlement process is unable to address agricultural trade restrictions with the immediacy required to limit market repercussions. In addition, even though trade restrictions could have immediate and wide-reaching impact on all players in the global market, remedies will only be available for those countries whose trade interests have been demonstrably adversely affected. Finally, no recourse is available to compensate those affected – whether losses were caused directly by the trade restrictions, or suffered indirectly as a result of increased prices or market volatility caused by those restrictions.

Providing a strong contrast with regard to penalties, the NAFTA provides for penalties to be levied against a government whose trade policies have caused damage to a trading partner's activities. In Cargill v. United Mexican States, the Mexican government was ordered to pay Cargill damages amounting to $77 million (USD). There is no similar deterrent measure available under the WTO regime; it is difficult to see that a WTO member would be strongly deterred from introducing trade restrictions if the only potential consequence is that it will have to lift those restrictions in future.

Moving Forward

Policy options

With human welfare dependent on the health of the global agricultural market, it is crucial that governments look toward coordinating policy responses at an international level to reduce trade disruption and thereby help to maintain well-functioning agricultural markets – not only for the benefit of agricultural commodity producers, suppliers and distributors, but also agribusiness investors and commodity traders, and each of us as an end-consumer of food commodities and biofuels.

(a) Information services

The quality of agricultural information will ultimately play a crucial role in the ability for our global agricultural markets to cope with shocks. The experience of the 2007-2008 food price crisis also highlighted weaknesses in the coordination of policy responses to food price volatility. The Joint Policy Report recommended building on existing systems and improving global market information and policy guidance through a collaborative initiative, the Agricultural Market

Information System ("AMIS"). The structure of AMIS would include two groups: a Global Food Market Information Group responsible for food market information collection and analysis, and a Rapid Response Forum whose objective would be to promote international policy coordination.

(b) Improvements to the law

The law as it stands on export restrictions to agricultural commodities provides ample room for governments to apply export restrictions with little recourse for any other adversely impacted state. Suggestions at the multilateral level by import dependant countries include:

- the tariffication of export restrictions; and
- the binding and reduction of export taxes (although this has been met by opposition from developing countries).

There has also been discussion on improving the working definition. The Joint Policy Report recommended that the G20 governments should develop an operational definition of a critical food shortage situation that might justify consideration of an export restricting measure. An export ban would be defined as a time-limited measure of last resort, allowed only once other measures have been exhausted and taking into account the food security needs of least developed countries and net food importing developing countries.

The Joint Policy Report also recommended that the consultation and notification processes currently in place need to be widened, strengthened and enforced. The intention to impose an export restriction would have to be notified in advance of the action being applied and a "fast track" consultation process could be put in place to discuss whether the measure can be avoided and how. Regular and ongoing consultation would take place with a view to removing any measure applied at the earliest possible moment.

(c) Investment into agriculture

A key element in any long term solution for reducing agricultural price volatility and to ensure continued agricultural production growth will be to increase investment in farming and agribusiness. Through direct investment in agriculture, agribusinesses gain access to additional resources to improve the quality, quantity and productivity of agricultural inputs, and investment in downstream infrastructure can help to improve the effectiveness and efficiency of yields and commodity distribution systems.

The need for investment into developing countries' agriculture sector is especially important, as there are many far-reaching potential gains to be realised by increasing the productivity and resilience of developing countries' agriculture. For example, waste due to post harvest losses, inadequate storage and infrastructure and under developed markets are a huge issue in developing countries. Investment in these areas would contribute to reducing waste and increase the quantity of food reaching the market, and thereby reduce the pressure on increasing food production to meet growing demand.

Direct investment can provide access to resources including land, capital and inputs such as seed and fertiliser, and fund research and development to improve the productivity of those inputs through innovation in methods and machinery; downstream investment in infrastructure and distribution services may help to improve both the efficient use, and effective distribution of, agricultural outputs.

(d) Public / private partnerships

The Joint Policy Report estimates an average annual net investment of USD 83 billion (in 2009 USD) is required to meet the agricultural production gains needed to ensure food security. This estimate includes investment needs in primary agriculture and necessary downstream services such as storage and processing facilities, but does not include other essentials such as irrigation projects and roads. Such public sector investment is crucial in developing countries, but it is unlikely to be realised due to an inadequate level of government resources. Private sector investments into agriculture will therefore form a crucial part of the solution to the stabilisation of international agricultural markets and long-term food security

(e) Investment initiatives – EBRD

The European Bank of Reconstruction and Development ("EBRD") has recognised the current strains on food supply and the need for investment in areas where it has discovered large untapped production potential. A recent study by the EBRD and FAO finds that average yields in the relevant regions could be lifted by as much as 75 per cent and that vast areas of land can be returned to production at limited environmental costs. The study finds that Russia, Kazakhstan and Ukraine alone could quickly increase their arable land under production by returning to use 13 million hectares of land that has not been used since the early 1990s. With demand for cereals for both food and animal feed uses projected to reach approximately 3 billion tonnes by 2050, up from current levels of nearly 2.1 billion tonnes, this region could provide part of the solution. A high level of investment, however, is required to realise these gains; 40 to 80 billion USD of investments are required for Ukraine alone. The EBRD proposes that the solution can be provided by the private sector, estimating that two third of the investments will have to come from this sector.

The EBRD takes a two pronged approach to agribusiness. First, debt and equity investments; and second, technical cooperation and policy dialogue. In its investments, the EBRD has adopted a total food value-chain approach: it invests from farming and processing to logistics and retail, all in the private sector. In 2011 the European Bank of Reconstruction and Development (ERBD) committed €945 million to agribusiness projects. With a portfolio of more than €3 billion this makes the EBRD the largest provider of finance to private agribusiness enterprises in Central and Eastern Europe and Central Asia. The EBRD has extended loans and equity investment directly to primary agriculture companies in Eastern Europe, Central Asia and the Balkans. Infrastructure and trade logistics are a secondary priority, with programmes set up to smooth out bottlenecks by improving transport modes and providing access to seasonal finance.

Conclusions

Price increases caused by export restrictions have a detrimental effect globally. In addition to the impact on end-consumers, trade barriers damage the well established trade flows and may result in a break down of trust between nations. They create a scarcity of food supplies in some countries and stockpiling in others, thus causing an imbalance in global food distribution. Open and stable markets will be key to enabling the international community to stabilise food prices and work toward guaranteeing future food security.

After another dismal crop year for most of the world's largest exporters, food markets are on edge and it seems that the effectiveness of WTO rules may likely be tested once again. Past experience suggests that without meaningful penalties, the WTO's rules will simply not be strong enough to deter its members from imposing restrictions on trade and for this reason we believe that the ongoing impact of the WTO rules on export restrictions will continue to be muted.

In addition to enhancing the effectiveness of WTO rules, food security concerns must be tackled. As the world population grows and consumption needs continue to increase, expansion of agricultural productivity must follow suit. Increases are needed to both government and private sector investment into agriculture, especially investment to improve farming technology and increase yields, and in areas that will develop the transport infrastructure needed to enable more agricultural production to reach the international marketplace. By diminishing underlying concerns over access to food, market players would be less prone to extreme policy reactions.

Lessons learned

With commodity prices once again sitting at close to record levels, and with crop reserve stock levels at historic lows, developments over the next few months will show whether or not the international community has learned from the 2007-2008 and 2010-2011 food price crises.

Effective information systems

We have noted the importance of reliable access to accurate market information, and stress the need for continuous improvement to agricultural information systems. Where appropriate alarms are raised early, necessary discussions can be had and decisions made as early as possible. In particular, the Rapid Response Forum should meet as soon as warning signs begin to emerge in the market so any risks can be discussed at as early a stage as possible.

New international bodies set up to specifically disseminate market information or to discuss topics such as food prices will go a long way toward eliminating the uncertainty currently present within agricultural markets, such as that observed when speculation and mixed messaging about Russian intentions to implement trade restrictions caused Russian grain prices to jump 4% during one week in September 2012.

The emergence of moral policing

There is recent evidence to suggest that a form of self-policing has begun to emerge among WTO members. Calls from the international community urging any country considering an export ban to also consider the serious repercussions it could have on the world market reflect an emerging moral ethos that gives recognition to international obligations and to the potential global impact of imposing agricultural trade restrictions.

The circumstances and rumours surrounding potential Russian and Ukrainian wheat export bans in September and October 2012 provide significant examples of restraint now being shown where export bans were previously introduced. Ukraine has sought to limit exports of wheat through agreements with traders instead of unilaterally banning exports. Russia, on the other hand –despite an expected crop that is smaller than the 2010 crop on which it imposed export bans – did not resort to restricting trade and instead allowed exports to slow naturally, as the price of domestic wheat rose in response to its failed crop.

If the international community can continue to self-police by invoking moral obligations, a more holistic and coordinated approach to international agricultural trade policy may be on the horizon.

Finding New Funding – International Trade Receivables Financings

Agribusiness companies have vast customer bases spanning many different jurisdictions. In order to be able to meet the needs of all their customers, these companies need to be able to adapt their corporate structures to deal with tax, accounting or legal constraints in all these varied jurisdictions. This can involve opening a local branch, creating a local subsidiary, obtaining local licences or getting local tax rulings. The question of how each local business is financed must also be considered.

It may be possible to locally finance each local business but in the modern globalised world, CFOs of many agribusiness companies look for a single funding option for all their operations, all around the world.

One financing technique, a trade receivables financing, is proving to be a funding solution to a number of agribusiness companies. For instance, in June 2011 Bunge announced its US$700m trade receivables financing programme which is funded by a consortium of bank sponsored ABCP conduits. Archer Daniel Midlands also have a US$1bn accounts receivable financing programme in place.

To aid us in looking at this let us briefly consider a typical structured trade receivables financing:

1. an SPV will be incorporated which will be funded by the lender;
2. the SPV will purchase receivables at a discount from the company; and
3. the lender will want to ensure the accounts the debtors pay into are controlled, or can be controlled, by it.

In general, the key private international legal issues this type of transaction faces fall into three categories: recognition of foreign law and judgements, divorcing credit risk and control over bank accounts. We shall consider each of these in turn.

Why are trade receivables financings becoming more popular?

One reason for trade receivables financing becoming increasingly common (in particular in the agribusiness sector) may be the steady harmonisation of private international law systems around Europe and the rest of the world.

For instance, in the European Union there are the Rome I and Brussels I Regulations along with the European Union Insolvency Regulation and there are some common themes in the rest of the world in private international law theory along with the UNCITRAL Model Law on Cross Border Insolvency. As we will see, these all help in making the legal framework that trade receivables financings are structured in more certain and predictable.

Recognition of Foreign Law and Judgments

A lender will always want comfort that, if they need to, they (or the SPV that purchased the receivables) can go to the country a particular underlying debtor is in and ask that underlying debtor to pay it directly. This principally involves the local court needing to (i) recognise a foreign judgment saying that a underlying debtor owes the money directly to the lender (or SPV) or (ii) recognise the sale of the receivables to the SPV under the relevant sale agreement and consequently that the lender (or SPV) is the correct person the underlying debtor should be paying. The lender (or SPV) would also need to ensure any local law perfection requirements were complied with.

In the European Union the answers to these questions are relatively straightforward. A foreign judgment obtained in another member state should be recognised under the Brussels I Regulation and the sale of receivables to an SPV should be recognised under the Rome I Regulation if (i) it is permitted under the law governing the receivable and (ii) it is valid under the law governing the agreement under which the SPV purchased the receivables.

Although recognition of foreign judgments becomes more patchy outside the European Union (unless a particular mutual recognition treaty is in place) there is a large number of jurisdictions which will recognise the validity of the sale of receivables and allow local enforcement of the sale contract. They may do this by looking at the law governing the receivable and the law governing the sale agreement and considering whether the sale is valid under either or both of those laws. In both cases, this particular private international law question is usually well settled in most jurisdictions encountered and so can be checked with relatively little difficulty by a local lawyer.

Divorcing credit risk

Transactions are structured by use of a sale of receivables in order to divorce the credit risk of the receivable from that of the relevant company. In an insolvency of the company the lender would want the receivable to fall outside the company's insolvent estate. The location of the company's insolvency, and therefore which court has jurisdiction over this question, is key.

Again, as between EU member states this question is relatively straightforward. The EU Insolvency Regulation uses the "centre of main interests" of a company to determine the location of its main insolvency proceedings. There may also be secondary insolvency proceedings in other EU member states where a company has branches. So, to ascertain whether the sale of receivables is sufficient to remove them from the company's insolvent estate there is only a limited number of jurisdictions that need to be consulted.

A number of non-EU countries have adopted the UNCITRAL Model Law on Cross Border insolvency which also has a concept of a company's centre of main interests and provides for courts in one jurisdiction to assist where insolvency proceedings are taking place in another jurisdiction. This may involve granting local relief or enforcing a "stay" in the local proceedings. While it does not clarify which jurisdictions proceedings can or cannot take place in, it does give more predictability on how insolvency proceedings may be run and mechanisms can be added to the transaction documents to deal with local jurisdictional worries if required. This helps reduce the number of questions local lawyers need to answer in order to structure a transaction as strongly as possible to withstand insolvency.

Control over bank accounts

Obtaining control over the bank accounts is one area where private international legal principles are not yet so uniform. For instance, in the UK (and a number of other Commonwealth jurisdictions), declaring a trust over a bank account will essentially protect the cash in that account from an insolvency of the company but in other jurisdictions a pledge or charge may need to be granted and detailed account control provisions agreed to ensure the local bank will act in accordance with the instructions of the lender or its security trustee. Putting these local arrangements in place involves local lawyers drafting local law security documents and complying with local law formalities. Cross-border recognition of this sort of security is not yet common place and putting this local account security in place is often very costly and time consuming.

One solution some lenders have adopted is simply opening up local bank accounts in the name of the SPV and notifying the underlying debtors to pay directly into these accounts. In the event of a company insolvency the cash is then safely in an account already controlled by the lender. However, this mechanism is often resisted as companies often have sensitive relationships with their local collection account banks and customers.

Another protection that is sometimes included in transactions is the ability to notify underlying debtors to pay into a non-company account if the company appears to be getting into financial difficultly. If the underlying debtor then pays into the wrong account the receivable is not properly discharged and (although very rare in practice), provided the local court recognises the relevant purchase document (as to which see "*Recognition of Foreign Law and Judgments*" above), the lender (or SPV) could go after the underlying debtor directly for payment.

Conclusion

The harmonisation of private international laws has certainly improved the legal robustness of trade receivables securitisations, particularly inside the EU with respect to recognition of the legal nature of the transaction and how the transaction will be treated in a company's insolvency. Controlling the cash and accounts is still the most complex and expensive part of these transactions; however, the structural mitigants described above often provide some comfort for lenders and may reduce the need for detailed local law advice.

This improved legal robustness also helps reduce the cost of implementing these transactions by minimising the scope and quantum of work to be undertaken in multiple jurisdictions.

As this legal certainty helps lenders focus more on commercial rather than legal risk, trade receivables financings are proving ever more popular for lenders and allowing large agribusiness companies to diversify their funding sources away from traditional bank lending and directly accessing the capital markets to a more cost effective source of liquidity and general working capital.

Sowing the Seeds – Cultivating Foreign Investments in China's Agricultural Sector

With a growing population of 1.3 billion and with over 900 million people living in rural areas, China faces increasing local consumption and pressures on its land, of which only 14% are arable. Whilst productivity of farmland has improved in the past few years due to the efforts of the Chinese government in improving farming policies and technologies, the enormous pressure of feeding China's vast population has led to it not only becoming a bigger importer of agricultural commodities in recent years but also an increasingly active investor in foreign agricultural projects.

The Chinese government has no intention, however, to neglect its domestic agricultural sources despite the increasing import volumes and foreign investments, and continues to strongly promote agricultural self-sufficiency. Local farmers and provincial governments have been urged to ensure agricultural production, and reminded of the need to maintain a steady output of grain and other agricultural products so as to help stabilise prices and keep economic development on track. This promotion of rural development is not only a measure to ensure food security, but is also a way of raising farmers' incomes to narrow the gap between the urban rich and rural poor.

In the latest 12th Five-Year Plan (2011-2015) released by the *National People's Congress* on 14 March 2011, various policy initiatives were announced for the purposes of ensuring long-term food security. These included accelerating the development of modern agriculture, expanding the skills and income of local farmers, promoting the development of bio-agriculture and production efficiency and improving rural infrastructure. China has also announced that it would welcome foreign investments in "modern agriculture, high-tech and environment protection industries". Coupled with the fact that Chinese leaders view agriculture as one of the foundations of China's economy, the agricultural sector will continue to be an attractive sector for foreign investors.

Legal regime on General Market Entrance by Foreign Investors

The PRC government has a classification system of industry sectors which are open to foreign investments. Such classifications are set out in the *Catalogue for the Guidance of Foreign Investment in Industries ("外商投资产业指导目录")* which was last revised on 24 December 2011 and came into effect on 30 January 2012 (the "Catalogue"). Sectors are categorised as either "prohibited", "restricted" or "encouraged". Those not specifically listed in the catalogue fall under the "permitted" sectors.

"Prohibited sectors" are off-limits to foreign investment.

"Restricted sectors" are subject to foreign ownership restrictions.

Notwithstanding such classifications, the State Council may, from time to time, issue ad-hoc policies restricting foreign ownership in specific sectors. The classification of a foreign-invested project under the Catalogue will affect the level of authorised approval required in respect of a proposed foreign-invested project. Generally, where the proposed business activities fall in the "encouraged" or "permitted" categories, the relevant approval can be granted by the local government authorities at county or city level. Where such business activities fall in the "restricted" category, the foreign investor must obtain the relevant approval from provincial or even central government. In both instances, the level of approval authority required will also depend on the amount of total investment of the project concerned.

Framework for Foreign Investments in the Agricultural Sector

According to the *PRC National Economic Sector Classification* and for the purposes of providing a broad overview on the legal framework in respect of the agricultural sector, this note divides the agriculture industry into the following sectors: farming, trading and agricultural products processing.

Foreign investment in the agriculture industry is subject to approval from the foreign investment regulators and industry regulator. The National Development and Reform Commission ("NDRC") and Ministry of Commerce ("MOFCOM") are the principal approval authorities governing the approval of foreign investment projects. Generally, NDRC is responsible for strategic and mid to long term planning for the Chinese agriculture industry, while MOFCOM regulates the import and export of the agriculture products, collects and analyses import and export data and carries out anti-dumping investigations. In terms of foreign direct investment, NDRC's role is more focused on the approval of projects with fixed asset investments, while MOFCOM is generally responsible for the approval of the articles of association of all types of foreign investment enterprises and contracts between investors.

In addition to approvals from the above foreign investment regulators, approvals from the industry regulator, namely, the

Ministry of Agriculture ("**MOA**") may also be required for investments made in certain agriculture sectors.

Farming

The *Agriculture Law ("农业法")* of the PRC sets forth various principles and measures designed to ensure the steady development of China's agricultural industry. These include registration or licensing requirements for the production or the use of agricultural production materials, such as farm chemicals, seeds, fertilizers, that may affect the health of human beings or animals. Specific approval and registration procedures are also required for foreign investment in the crop seeds enterprises.

Under the Catalogue, the following sectors relating to farming are classified as prohibited, restricted or encouraged:

Prohibited	Restricted	Encouraged
Study and cultivation of China's rare and precious species (including fine genes in plantation, animal husbandry and aquatic industry) and production of related materials	Selection and cultivation of new species of crops and development and production of seeds (Chinese controlling interest required)	Planting, development and production of wood-based edible oil, seasoning and industrial raw materials
Development and production of genetically modified crops including seeds and biological studies		Development and production of green and organic vegetables (including edible fungi, musk melon), dry and fresh fruit products, cultivation of tea leaves, development and production of a series of products
		Development of new technology in and production of agricultural products such as sugar-bearing crops, fruit trees, herbage and other crops
		Planting of rubber, sisal, coffee and palm oil

Trading

The *Regulations on the Administration of Food Products Distribution ("粮食流通管理条例")* regulates the purchase, storage, transportation, processing, import and export of wheat, paddy, corn, food grains and other food products.

Under the Catalogue, the following sectors relating to trading of food products are classified as encouraged or restricted:

Restricted	Encouraged
Wholesale, retail and distribution of cereal, cotton, vegetable oil, sugar, and tobacco (Note that chain stores with more than 30 branches which sell different types and brands of the above commodities from various suppliers must be controlled by a Chinese party).	Joint distribution of general merchandise, fresh produce and low-temperature distribution and other logistics-related technical services.

Agricultural Products Processing

Food production and the administration of the food industry is generally governed by the *Food Safety Law ("食品安全法"),* while the quality and safety of agricultural products, maintenance of public health and promoting the development of agricultural industry and economic development in rural areas is regulated by the *Agricultural Product Quality Safety Law ("农产品质量安全法").*

Under the Catalogue, the following sectors relating to agricultural products processing are classified as encouraged or restricted:

Restricted	Encouraged
Processing of cotton (seed cotton)	Processing of vegetables, dried and fresh fruit products and husbandry and poultry products
Processing of soybean oil, colza oil, groundnuts oil, cottonseed oil, tea-seed oil, sunflower oil, palm oil and other edible grease (Chinese controlling interest required); Processing of rice and flour; Deep processing of corn	

National Security Review

In 2011, China launched a national security review scheme for the acquisition of Chinese companies by foreign investors. This scheme is mainly composed of a notice issued by China's State Council on 3 February 2011 ("Notice") and a set of interim rules for the implementation of the Notice issued by MOFCOM on 4 March 2011, now replaced by a new set of MOFCOM provisions published on 25 August 2011 ("Implementing Rules").

The newly-introduced national security review scheme establishes China's first formal process for evaluating acquisition of Chinese companies by foreign investors that may raise national security concerns. Food self-sufficiency is considered a matter of national security and stability to the Chinese government. Any proposal which would cause a supply upheaval, affect the level of food self-sufficiency or cause instability in consumer prices is a cause for concern. With the implementation of this mechanism, foreign investors intending to engage in M&A activity in sectors that fall within the relevant scope (for example, key agricultural products) will now need to consider whether the proposed transaction will be subject to national security review in addition to other Chinese governmental approvals and merger control review.

Although M&A transactions of key agricultural products fall within the scope of the national security review, both the Notice and the Implementing Rules leave it unanswered as to what the "key agricultural products" are. We understand from informal enquiries with MOFCOM officials that an acquisition by a foreign investor of a Chinese company which is engaged in the business of growing grains and other crops will be subject to the national security review.

Although there does not appear to be a precedent so far, where a M&A transaction fails to obtain the clearance for the national security review, the PRC authorities are entitled to require the relevant parties to terminate the transaction or take other effective actions. For example, they may order the transfer of the relevant equities or assets in order to eliminate the adverse effect of the transaction on national security.

It is also worth noting that whether the merger or acquisition of domestic enterprises by foreign investors falls within the scope of security review is determined by the substance and actual impact of the transaction. A foreign investor may not, by any means, avoid the national security review process, including but not limited to the use of nominee structures, trusts, multi-level re-investments, leases, debt, contractual control or overseas transactions.

Conclusion

As of 2010, the Agriculture industry accounted for approximately 10.17% of China's GDP, an increase of approximately 4.3% from the previous year. Nonetheless, despite the improvements in local agricultural technology, China's production efficiency continues to lag behind its western counterparts. With strong backing by the Chinese government of the agriculture industry and with year-on-year increases in financial support, agriculture has become one of the most attractive industries for foreign investment.

Although China does regulate foreign investment in its agriculture sector heavily in a bid towards encouraging self-sufficiency, and in some respects, still directs its own market away from foreign companies, there are opportunities for foreign investors who are keen to enter this market. The agricultural industry in China has consistently been and will continue to be important with the Chinese government placing an emphasis on increased food production. Foreign investors who can introduce new technologies, increase productivity and improve rural infrastructure will be much welcomed by the Chinese authorities.

Food for Thought – Soft Commodity Derivative Trading and Mifid Review

Background to Mifid review

The European Union's Markets in Financial Instruments Directive ("MiFID") established a regulatory framework for the provision of investment services in financial instruments (e.g. investment advice and brokerage services) and for the operation of regulated markets (e.g. stock exchanges).

MiFID was subject to a mandatory post-implementation review in 2010. As part of the process, the European Commission is taking the opportunity to update MiFID in respect of market developments and to adjust those provisions which have not met the original objectives of the directive. One of the objectives of the review process was to introduce measures to improve oversight and transparency in commodity derivatives markets, particularly for hedging and price discovery purposes. The Commission published its formal legislative proposal for a new, restated version of MiFID ("MIFID II") and a new EU Regulation ("MIFIR") mainly covering transparency and market integrity issues in October 2011, following a public consultation. These proposals were amended in compromise texts published by the European Council in June 2012. This briefing discusses the key changes to the regulation of commodity derivatives under MIFID II and MIFIR.

Regulation of commodity derivatives

Commodity derivatives were first brought within the scope of EU wide regulation when they were introduced as a new category of financial instrument under MIFID. While the introduction proved beneficial for commodities firms who wanted to passport their business into other EU markets, in some jurisdictions it introduced licensing and other regulatory requirements for such firms, where none previously existed.

Following the financial crisis and perceived excessive volatility in commodity markets in the recent past, stronger supervision of commodity derivatives, to improve the efficiency, transparency and integrity of this market, became a key priority in the G20 regulatory reform agenda. In the US, reforms to the regulation of the commodity derivatives market were ushered in by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Key changes brought in by the Act included a new registration requirement for all swap dealers and major swap participants, clearing and trading requirements for standardized derivative products, a new regime for reporting of swap data, and granting the US Commodity Futures Trading Commission ("CFTC") powers to adopt position limits for swaps and futures.

In the EU, MIFID II and MIFIR form a key part of the regulatory reforms for the commodity derivative markets along with:

- The new European Market Infrastructure Regulation ("EMIR"), which requires mandatory clearing and reporting of over the counter ("OTC") derivative trades made by financial counterparties and non-financial counterparties whose trades exceed a pre-determined threshold. Consistent with the changes brought in by EMIR, MIFIR imposes a requirement on both financial and non financial counterparties exceeding the clearing threshold in EMIR that trading in suitably developed derivatives occur only on eligible platforms, that is regulated markets ("RMs"), multilateral trading facilities ("MTFs") or organised trading facilities ("OTFs"). The list of suitable derivatives will be specified by the Commission and the European Securities and Markets Authority ("ESMA") in the technical standards, and will take into consideration the liquidity of the specified instruments.
- The new market abuse directive and regulation ("MAD") which expand the definition of inside information to cover price sensitive information relevant to the commodity spot market as well as to the derivative market and extends the scope of cross market manipulation to cover transactions in the financial instruments (whether traded in the EU or outside) which are entered into to manipulate the price in the spot market and transactions in underlying spot commodity contracts affecting financial instruments admitted to trading on EU facilities.

The aim of the changes proposed by MIFID II and MIFIR, similar to the reforms initiated by EMIR and MAD, are to provide:

- Greater regulatory oversight of the commodity derivative market (by bringing more categories of commodity derivatives and firms within the scope of the directive) and more powers to the regulators (such as giving them powers to determine position management arrangements and position limits and giving them powers directly to intervene in the market and enforce these limits).
- Greater transparency for trades and prices on commodity derivative markets (through new pre and post trade transparency rules for commodity derivative markets).
- Detailed information on the trading activities of different types of market participants (through extensive transaction reporting requirements).

Who is affected?

MIFID II broadens the definition of financial instruments covered by the directive while narrowing the exemptions available to commodity firms. The following categories of commodity derivatives fall within the scope of financial instruments which are regulated by MIFID:

- Cash settled commodity derivatives;
- Physically settled commodity derivatives which meet any one of the following criteria:
  - that are traded on a RM or a MTF or on a third country trading facility that performs a similar function to an RM or an MTF;
  - that are expressly stated to be, subject to the rules of, or equivalent to a contract traded on an RM, an MTF or a such a third country trading facility;
  - that are cleared by a clearing house or other entity carrying out the same functions as a central counterparty, or there are arrangements for the payment or provision of margin in relation to the contract; or
  - that are standardised, so that terms like the price, the lot or the delivery date are determined by reference to regularly published prices, standard lots or delivery dates.

  MIFID II expands category (a) to include physically settled commodity derivatives that are traded on a OTF.

An OTF is very broadly defined to cover any system or facility in which multiple third party buying and selling interests are able to interact in the system in a way that results in a contract but where the operator has discretion as to the execution of the transaction (unlike an MTF which operates on non-discretionary rules). It will cover broker crossing networks and voice and hybrid brokers that cross client orders. OTFs will be prohibited from using their own proprietary capital to trade with clients through the OTF (to prevent conflicts of interest and ensure neutrality).

Under MIFID II, the following categories of persons dealing in commodity derivatives would be exempt from regulation under the directive:

- persons who provide investment services exclusively for group companies (Article 2.1(b) of MIFID II, this MIFID exemption remains unchanged);
- persons who do not provide or perform any investment service other than dealing on own account unless they are market makers, members of an RM or MTF, or are persons who deal on own account by executing client orders. (Article 2.1(d) MIFID II). The existing MIFID exemption has been significantly narrowed under MIFID II to exclude members of RMs or MTFs and persons executing client orders; and
- persons who:
  - deal on own account in commodity derivatives (other than by executing client orders);
  - provide investment services (other than dealing on own account exclusively for group companies) or
  - provide investment services (other than dealing on own account) to the client or counterparties of their main business,

  provided that in all cases this is ancillary to their main business when considered on a group basis and that their main business is not the provision of investment or banking services (Article 2.1(i) MIFID II).

  This MIFID exemption has been amended to specify the exceptions to the exemptions in the first two bullets above and to include a new exemption in the third bullet above for commodity firms which provide investment services to clients or counterparties of their main business.

A new provision (Article 2.3) in MIFID II clarifies that the criteria to determine whether any activity is ancillary to the main business of the group will include (a) the extent to which the activity is objectively measurable as reducing risks directly related to the commercial activity; and (b) the capital employed for carrying out the activity.

MIFID II however deletes a key exemption that is currently available to firms whose main business consists of dealing on account in commodities or commodity derivatives under Article 2.1(k) of MIFID. Unless these firms now fall within any of the exemptions listed above, they will now be regulated under MIFID II.

Firms who provide investment services in commodity derivatives which are regulated by MIFID II, and are not otherwise exempt under Article 2 of the directive, will be required to obtain a licence and to comply with other regulatory requirements such as conduct of business rules (including rules on client classification, best execution and remuneration). They may also be subject to capital requirements for licensed firms, though there are specific exemptions available for firms whose business consists only of commodity derivatives.

Position management and position limits:

There has been considerable debate on whether granting regulators the power to impose hard position limits on the derivative market or adopting a more flexible position management approach would be more effective in deterring excessive volatility and speculation in the underlying commodity market. Position limits are predetermined fixed limits, on the size of the derivative position that a market participant can hold for a specific underlying commodity over a given period of time in that market. The Dodd-Frank Wall Street Reform and Consumer Protection Act gives the CFTC the power to adopt position limits for derivative positions in certain agricultural commodities in the US. In contrast, regulators in the UK prefer a position management approach, where exchanges would actively monitor member's derivative positions and determine on a case by case basis if a position could distort the market.

The MIFID II and MIFIR proposals on position management and limits are consistent with the International Organization of Securities Commissions (IOSCO)'s principles for the regulation and supervision of commodity derivative markets (which was prepared in response to the G20 request for further work on this area).

MIFID II requires RMs, MTFs and OTFs to apply position management arrangements including position limits, in order to:

- prevent market abuse; and
- support orderly pricing and settlement conditions.

Details of these limits and position management arrangements will be published on the website of ESMA.

Amendments made in the EU Council's compromise text on MIFID II clarify that position limits will be determined according to the following criteria:

- whether the financial instrument can be physically settled or cash settled;
- the maturity of the commodity derivative contracts;
- the deliverable supply in the underlying commodity;
- the overall open interest in the respective commodity derivative contracts;
- the overall open interest in other financial instruments with the same underlying commodity;
- the level of volatility in the relevant markets, including the substitutable derivatives and the underlying commodity markets; and
- the number and size of the market participants

The Commission is required to adopt delegated acts on position limits as well as conditions for exemptions. The conditions for exemption shall take account of the extent to which a position is objectively measurable as reducing risks directly related to the commercial activity or the treasury financing activity of a non financial entity. A national regulator cannot impose limits which are more restrictive than those imposed by the Commission unless they are objectively justified and proportionate taking into account the liquidity of the specific market and the orderly functioning of the market.

RMs, MTFs and OTFs are also required to:

- make public a weekly report with aggregate positions (which exceed a certain minimum threshold) and the number of long and short positions held by different categories of traders for the different financial instruments traded on their platforms and specify the number of traders in each category; and
- provide competent authorities with a complete breakdown of positions of all persons including the trading members and the clients thereof on that trading venue, upon request.

Members of RMs and MTFs are required to report to these markets the details of their own positions in real time, as well as those of their clients.

MIFIR gives ESMA a co-ordinating role in ensuring that regulators at the national level adopt a consistent approach to position management, including the setting of position limits. MIFIR also gives ESMA powers to:

- directly intervene to request information regarding the size and purpose of a position taken by a person;
- reduce the size of the position; and
- limit the person's ability to enter into a commodity derivative,

  in order to address a threat to the orderly functioning and integrity of the financial market or the stability of the financial system, where the relevant national regulator has not taken appropriate measures to address the threat.

Pre and post trade transparency rules

MIFIR introduces a new transparency regime for non equity markets (i.e. bonds, structured finance products and derivatives). Market operators and investment firms operating a trading venue shall:

- **pre-trade transparency requirement:** make public the prices and depth of trading interest at those prices for orders or quotes advertised through their system and for actionable indications of interest. This information shall be made publicly available during normal trading hours. A competent authority may be able to waive the obligation in certain limited circumstances such as if the market is restricted to trading with professional participants or if the financial instrument does not have a sufficiently liquid market; and
- **post trade transparency requirement**: make public the price, volume and time of the transactions executed as close to real time as technically possible.

New transparency obligations have also been introduced for systemic internalisers (SI) (i.e. an investment firm which on a frequent and substantial basis, deals on own account by executing client orders outside an RM, MTF or OTF), who provide quotes to clients for OTC derivatives that are traded on an MTF or OTF or are eligible for clearing. Where an SI responds to a request for quote, it will need to make a firm quote available to other clients and where the size of the trade is below a pre-defined size commit to trade with clients on that quote and to publish the quote details (with limited protection against multiple transactions).

Transaction reporting:

MIFIR extends the application of transaction reporting requirements, which was limited under MIFID to financial instruments admitted to trading on a RM (including transactions in such instruments which were executed outside the market). Under the compromise text of MIFIR published by the Council in June 2012, investment firms which execute a transaction in any financial instrument will be subject to transaction reporting requirements unless:

- they are transactions in instruments which are not admitted to trading nor traded on an RM, MTF or OTF; or
- they are transaction in instruments whose price does not depend or affect a financial instrument traded on an RM, MTF or OTF;

The reports shall include details of the trade, (such as date and time of execution, quantity and transaction prices), details of the person within the firm and the algorithms responsible for the investment decision and a designation to identify short sale of shares or sovereign debt.

Investment firms can choose make these reports to the competent authority either directly, through an approved reporting mechanism or through the RM, MTFs or OTF on which the trade was executed.

RMs, MTFs and OTFs have an obligation to report details of all trades executed on their platform, which are executed by a firm which is not subject to transaction reporting requirements and shall provide instrument referencing date on each financial instrument traded in an electronic and standardised format to ESMA.

Investment firms and RMs, MTFs and OTFs have an obligation to details of all transactions in financial instruments that they have executed or which are advertised through their systems for at least 5 years.

Next steps

The proposed text of MIFID II and MIFIR (including the changes set out above) are currently being negotiated by the European Parliament, Council and Commission. The directive and regulation are expected to be finalised and adopted in early 2013. MIFIR will come into force 24 months after the regulation is adopted, with a few provisions coming into force immediately. The timeline for implementation of MIFID II is currently under negotiation.

Digging Deep Down Under – Foreign Investment in Australian Agriculture

In common with other countries, there has been considerable and recent public debate on the scale of foreign investment in Australian agribusinesses and agricultural land. This is notwithstanding that a recent report indicated that there has been minimal change in foreign ownership levels of agricultural land in Australia since 1984. However, in recent years there have been a number of high-profile acquisitions of Australian agribusinesses as well as many smaller acquisitions of agricultural land that have prompted concerns about the level of foreign ownership in the sector.

Australia's foreign investment regime

The Australian Treasurer is the ultimate decision maker as to whether an investment into an Australian agribusiness is acceptable or objectionable in Australia's national interest, in accordance with Australia's foreign investment regulation and policy. The Treasurer will take advice from a range of sources, primarily the Foreign Investment Review Board ("FIRB").

While the Australian Government generally welcomes foreign investment in Australia's agriculture, whether a potential agribusiness transaction will be subject to Australia's foreign investment review regime, and if so the successful navigation through the process is a key deal consideration.

Generally speaking, all non-US investors must notify the FIRB before acquiring an interest of 15% or more in:

- an Australian business or corporation that is valued above A$244 million (note: this threshold is adjusted each year in line with inflation in Australia); or
- an interest in an offshore company that holds Australian assets or conducts a business in Australia and the Australian assets or businesses of the target company are valued above A$244 million.

"The Australian Treasurer is the ultimate decision maker as to whether an investment into an Australian agribusiness is acceptable or objectionable."

If a US investor is making an investment in Australia which does not involve any of the Australia-United States Free Trade Agreement prescribed sensitive sectors (which do not include agriculture or other agribusiness), the threshold is A$1062 million.

Further, foreign investors that are a foreign government and a related entity of a foreign government must notify FIRB and obtain approval before:

- making a "direct investment" in Australia (generally any investment of an interest of 10% or more); and
- acquiring any interest in land,

regardless of the value of the investment. Interests below 10% may also be considered direct investments if the acquiring foreign government or related entity can use that investment to influence or control the target.

Criteria for assessment: National interest considerations

The role of FIRB is advisory only. FIRB considers proposals on a case-by-case basis and determines whether to recommend to the Australian Treasurer that the investment be approved or prohibited based on whether it is in the national interest.

Relevant considerations for whether an investment is in the national interest are:

- national security;
- competition;
- other Australian Government laws and policies (including tax and revenue laws);
- the impact on the economy and the community; and
- the character of the investor.

In the case of foreign government investors, consideration will also be given to whether:

- the investor's operations are independent from the relevant foreign government; and
- the investor is subject to and adheres to the law and observes common standards of business behaviour.

Foreign investment in Australian agriculture

In response to the ongoing debate relating to foreign investment in Australian agribusinesses and agricultural land, the Australian Government recently announced that it would:

- publish a policy statement on foreign investment in agriculture – in assessing foreign investment in agriculture applications, the Government will consider the affect of the proposal on the following:
    - the quality and availability of Australia's agricultural resources, including water;
    - land access and use;
    - agricultural production and productivity;

- Australia's capacity to remain a reliable supplier of agricultural production, both to the Australian community and its trading partners;
- biodiversity; and
- employment and prosperity in Australia's local and regional communities; and

- form a working group to consult on the development of a foreign ownership register for agricultural land. Currently, only the State of Queensland maintains a register of foreign land acquisitions in that State.

The Federal Opposition has also released a consultation paper on potential changes to the disclosure of information concerning foreign investment (especially in agribusinesses and agricultural land), thresholds for approval of acquisitions of agricultural land and agribusinesses, the national interest test, and the composition of the FIRB.

Where to from here?

Notwithstanding that some measures indicate that there has not been a sudden and dramatic increase in foreign investment in agriculture since the 1980s, questions have been raised about the quality of the data relied upon.

"The Australia Government's foreign investment policy recognises Australia is a capital hungry country that has always relied on foreign investment as a driver of employment and prosperity, including in its agricultural sector."

Accordingly, it seems to be accepted that the debate concerning foreign ownership of agricultural land would benefit from greater transparency regarding the levels of foreign ownership.

Clearly, with both the Government and Opposition proposing changes, there are going to additional requirements imposed on foreign acquirers of Australian agribusinesses and agricultural land.

At a minimum this will likely involve greater notification requirements for foreign acquisitions in the sector. However, given the Government's proposals are still at working group or consultation stage, it is still some time before these changes will likely come into effect.

The Australia Government's foreign investment policy recognises Australia is a capital hungry country that has always relied on foreign investment as a driver of employment and prosperity, including in its agricultural sector.

Given Australia's regional position and capital constraints, foreign investment will continue to play an important role in maximising food production and supporting Australia's position as a major net exporter of agricultural produce.

Whether an investment into an Australian agribusiness will be subject to review under Australia's foreign investment regime will depend on:

- the nature of the investor (private enterprise, government enterprise or quasi private/government enterprise);
- the jurisdiction of the investor: United States based or otherwise; and
- the nature, size and scale of the transaction.

Fertile Grounds: Agribusiness in Brazil – Trends and Opportunities

Rising population levels, increased demand for energy and uncertainty over the potential impact of climate change have consistently been identified as concerns for the coming decades. Particularly in times of global economic uncertainty, job creation and the development of new industries are key policy goals in many regions. In Brazil, the sugar and ethanol industry has shown it is capable of providing solutions for these problems. The industry is a major contributor to Brazil's economy; a significant employer, a sustainable energy source and a platform for technological innovation.

The scale of the agribusiness sector in Brazil, which is now the sixth largest economy in the world, is striking. Brazil is the world's largest producer and exporter of sugar, sugarcane-derived ethanol, coffee, orange juice, and among the top five producers of ethanol from all sources, bulk soya beans, corn and beef, chicken and pork. The largest sub-sector by multiple measures, sugarcane and its derivatives, has been estimated to employ millions of people throughout Brazil and is thought to constitute billions of dollars to Brazil's GDP. In Brazil, sugarcane is used primarily for food and beverage production, fuel for automobiles and electricity generation. The majority of cars sold in Brazil today can run solely on ethanol. Other uses of sugarcane include the production of bio-plastics and fertilisers. Certain products derived from sugarcane may also be eligible for carbon credit trading under worldwide emissions trading schemes.

> "Almost uniquely in the world, drivers can – and regularly do – switch from an ethanol-petroleum mix to pure ethanol in the same fuel tank."

This article discusses two key themes:

- *Trends of increasing commercialisation and modernisation*

  The sugarcane sucrose and ethanol sector in Brazil has seen significant trends of commercialisation and modernisation in recent periods. We see scope for accelerated improvements given the current and future economic and legal framework. In particular, modern corporate structures and management strategies, increased mechanisation and more commercially-minded operating models present opportunities for Brazilian and global investors.

- *Opportunities in Brazil and globally*

  We also see a range of possible opportunities in Brazil and globally with respect to the sugar and ethanol industry. Within Brazil there is likely to be increased demand for logistics services as well as for finance to fund industry consolidation and mechanisation. Looking outside Brazil, there have also been a number of technological innovations which have been developed in Brazil and which could be further developed and applied elsewhere, with Africa presenting particular opportunities in this regard.

Trends of increasing commercialisation and modernisation

Traditionally, sugar farms have been small, family-led operations. Independent cane-growing farmsteads and small plantations have characterised the industry in Brazil but over recent years the industry has been consolidating. A number of major corporations have emerged, with small mills merging with other small mills, and these larger groups taking over other independent players to expand further. This trend has had a number of effects including the intended gains from scale economies. But two key factors appear to be morphing the industry players into modern and dynamic businesses.

First, the old corporate structures are modernising. Where family members and trusted friends used to run the show, businesses are hiring external talent with relevant experience and management expertise to reduce inefficiencies and scope out opportunities that had not previously been considered. This may be simply driven, in part, by the increased availability of relevant human capital, with technical and business experts having increasingly gained experience overseas. But it may also be a result of a cautious but growing confidence within Brazilian business, driving ambition and a belief that Brazilian industry can solve its own problems and stand tall in the world.

Second, the Brazilian sugar and ethanol powerhouses are reaching out to international investors – and international investors have been interested by the prospects they see in Brazil. In 2008, oil major BP acquired a 50% share in Tropical BioEnergia S.A., an ethanol business with key operations in the inland state of Goiás. Originally a joint venture with certain domestic mill operators, BP subsequently increased its stake to 100%. Separately, Royal Dutch Shell formed a joint venture with Cosan S.A., to form Raízen S.A., the largest sugar and ethanol company in Brazil. International investments such as these have brought new management practices to the industry. They have also provided direct cash injections and facilitated more efficient access to international capital markets. The newly available funds are being applied towards long-term growth opportunities.

Aside from management structures and corporate organisation, modernisation is likely to be an increasing trend from a technical perspective. Currently, sugar-growing in Brazil is relatively unsophisticated, employing hundreds of thousands of agricultural workers to tend and harvest the crop. Labour is cheap and this has been a key factor in the rise of the industry. However, relative to other developing countries, Brazilian businesses face high numbers of employee claims – many dragging on for years and ending up in courts or tribunals. The degree of employee litigation often surprises international investors in Brazilian companies.

These factors, together with the economic benefits of increasing production efficiency, are some reasons why the industry seems likely to mechanise over the coming years. Mechanisation is likely to boost crop yields by making it more manageable for sugarcane to be grown across a greater area. However, inevitably, this will result in at least temporary job losses for which the Brazilian Sugarcane Industry Association (*União da Indústria de Cana-de-açúcar* – UNICA) is seeking to prepare, having launched a "retooling" programme to retrain existing agribusiness workers.

The sugar and ethanol industry also sees growth coming from areas beyond making existing cane-growing, refining and distilling practices more efficient and larger scale. There seems to be an increasing belief in the potential of "second generation" cellulosic ethanol which, in Brazil, may be produced from the organic waste-products of sugarcane production. Research and development activities – including with respect to the use of enzymes to facilitate the viability of cellulosic ethanol – are being stepped up. It may be increasingly possible and profitable for bagasse – a by-product of the sugar crushing process – to be used to produce second generation alcohol fuels. Sugar and ethanol mills already produce electricity from their activities. The Brazilian government's Energy Research Organisation ("*Empresa de Pesquisa Energética – EPE*") estimates that, in 2011, 150 sugar mills sold surplus power from cogeneration activities to the national power grid.

Much of the scientific and technological research in the sugar and ethanol sector in Brazil has historically been initiated and run by non-profit making actors. In 1975, the government-instigated *Proálcool* programme kick-started Brazil's ethanol industry. State and federal university faculties continue to research technologies and agribusiness practices. The industry-backed non-profit institute CTC is responsible for much of Brazil's sugar and ethanol R&D activities. However, as the push for pioneering and innovative uses of the by-products of the sugar and ethanol production process gains further momentum, and businesses in the field of sugar and ethanol production become more sophisticated, it seems likely that corporate players will get more directly involved in research and development. This may involve more business-backed university research programmes and the movement towards a profit-making model for certain research programmes.

Opportunities: capitalizing on industry trends

We see the trends of corporate modernisation, international investment, technical mechanisation and an emphasis on research continuing and potentially giving rise to the following opportunities:

- The scope for M&A activity is far from saturated, although recent changes to Brazilian competition legislation mean that mergers or joint ventures face new hurdles where antitrust may be a concern. Previously the competition regime was non-suspensory – allowing proposed transactions to go ahead without the parties having to wait for regulatory clearance. As of this year, however, pre-approval will be generally required in many instances. As yet, it is unclear just what effect this will have on M&A activity because we do not yet know how long the competition authority will take, in practice, to make decisions on potential transactions.

"There are opportunities for significant further consolidation of the remaining smaller farms and mills, and investment in new and modernised facilities."

- Mechanisation, technological innovation and industry consolidation all require significant funding. It is estimated that developing infrastructure and implementing modern agribusiness practices will require investment in Brazil of billions of dollars. The cheapest finance available to Brazilian businesses often comes from government sources such as the Brazilian national development bank, BNDES. But as agribusiness players grow and modernise – in terms of scale, management practices and corporate organisation structures – there is likely to be an increased desire to borrow in the international loan markets and to issue debt securities in Brazil and on international exchanges.
- The ability to export technologies and innovative industry practices to other countries around the world is becoming a real opportunity. Since the 1970s, Brazil massively increased the area of land that could be viable for sugarcane-growing. It has been estimated that the area planted with sugarcane in Brazil has increased five fold in the last fifty years. There is

increased talk of applying the "Brazilian model" to other countries, and particularly those in Africa are seen to be potential recipients of technology transfer. Eventually, it is possible that ethanol-fuelled automobiles could become commonplace around the world outside of Brazil.

- Changing legal and regulatory frameworks worldwide may also present future opportunities for Brazilian producers of sugar and ethanol. Ethanol produced from corn has, until recently, been eligible for massive, longstanding government subsidies in the United States. With Brazil's largest competitor in the global ethanol industry now having to compete without direct government aid, opportunities to export Brazilian ethanol may be expected to multiply. However, European Union restrictions on sugar imports from Brazil remain in place and this legal barrier to exporting does not look set to ease in the foreseeable future.
- As the sugar and ethanol industry grows in size and sophistication, the infrastructure needed to support the sector will also need to improve. Currently, road networks (particularly outside of São Paulo state) are poor, and the railway network is very limited. Ports are overworked and loading and offloading times hold up the efficient transit of goods. There is demand for growth in the logistics industry and signs that sugar and ethanol companies themselves may take matters into their own hands if the market (or government) does not otherwise improve things.

"Brazil suffers from the natural disadvantage that distances from agricultural growing areas to cities and ports can be long and the terrain difficult."

Conclusions

The sugar and ethanol industry in Brazil has achieved a significant level of development, leading globally in terms of both supply, producing and exporting more sugar and sugar-based ethanol than any other country, and demand, with by far the world's the highest proportion of light vehicles fuelled by ethanol. These developments look set to continue.

We have identified a number of sector trends, including industry consolidation, modernisation of management structures and corporate organisation, mechanisation of the crop harvest process and investment in complex research and development. These trends present opportunities within Brazil and internationally. Within Brazil, capital will be required to fund corporate change, mechanisation and new technologies. There is also great demand for better logistics. World markets may also be increasingly suitable destinations for Brazilian sugarcane and sugar derivatives. In developed and developing economies there is the potential to use Brazilian expertise and experience relating to ethanol as fuel for consumer vehicles. Regions around the world with limited experience in successful agriculture may benefit from replicating the Brazilian success story. Making use of Brazilian scientific and logistical advances, various African countries may be able to turn under-exploited land with seemingly limited potential into bountiful cropfields. In turn, this could provide a source of jobs, food and profit in what could be a potential new industry in parts of the continent.

Political, legal and natural factors, both specific to the agribusiness sector and general to Brazil, pose hurdles for those operating or investing in the agribusiness space. But increasing confidence, expertise and experience abroad among domestic players, built on São Paulo's historic coffee-growing roots, together with a global desire to shift towards "green" energy, means we see scope for Brazil to build on its foundations as one of the world's leading agribusiness economies.

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Acknowledgements

We would like to thank the following people for their contributions to this publication:

Matthew Ball

Kane Barnett

Caroline Dawson

Carolyn Huang

Ashley Hunt

Christopher Norman

Nakita Patel

Lakshmi Ravindran

Nick Spurrell

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