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Modernizing the legal framework for secured commodities financing: The UNCITRAL/UNIDROIT Project on Warehouse Receipts

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The UNCITRAL/UNIDROIT Project on Warehouse Receipts

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The UNCITRAL/UNIDROIT Project on Warehouse Receipts: Introduction

The food security challenge

- “[...] feeding a world population of 9.1 billion people in 2050 would require **raising overall food production by some 70 percent over the period from 2005/07 to 2050 (nearly 100 percent in the developing countries)**. This translates into significant increases in the production of several key commodities. Annual cereal production for instance will have to grow by almost a billion tonnes, meat production by over 200 million tonnes to reach a total of 470 million tonnes in 2050, 72 percent of which in the developing countries, up from the 58 percent today.” (FAO, “Global agriculture towards 2050”, High Level Expert Forum - How to Feed the World in 2050, Rome, 12-13 October 2009)
- Market institutions, such as traders’ associations, and intermediaries, both at local and national levels, “can play a key role in reducing transaction costs, facilitating livestock trade and achieving market integration at the regional level”. Need to develop “**policies and strategies that reduce transaction costs and barriers to market access for poor livestock keepers and explore policy options that might reduce these market distortions**”. Important to “identify areas of institutional change that could strengthen poor livestock keepers’ links to mainstream livestock and livestock product markets.” (Livestock Thematic Papers - Tools for project design, IFAD, Rome 2010)

The UNCITRAL/UNIDROIT Project on Warehouse Receipts: Introduction

Business models for the rural value chain

- **Contract farming:** pre-agreed supply agreements between farmers and buyers.
- **Management contracts:** arrangements under which a farmer or farm management company work agricultural land belonging to someone else.
- **Tenant farming and sharecropping:** management contracts in which individual farmers, for example smallholders, work the land of larger-scale agribusiness or other farmers
- **Joint ventures:** entail co-ownership of a business venture by two independent market actors, such as an agribusiness and a farmers' organisation.
- **Farmer-owned businesses:** formally incorporated business structures for farmers to pool their assets to enter into certain activities (e.g., processing or marketing), gain access to finance, or limit the liability of individual members.

(Vermeulen & Cotula, *Making The Most of Agricultural Investment*, IIED/FAO/IFAD/SDC, London/Rome/Bern 2010)

The UNCITRAL/UNIDROIT Project on Warehouse Receipts: Introduction

The role of collateral in financing agriculture

- **Land acquisition and facilities development** (land purchase, storage facilities, land improvements, farm holding expansion)
 - Long-term loans
 - Debtor/Asset-based financing (personal guarantees, pledge of shares, land mortgages)
- **Operation loans** (buying livestock, agricultural implements, machinery or equipment, facilities improvement)
 - Mostly medium-term loans
 - Debtor/Asset-based financing (personal guarantees, mortgages, financial leasing, floating charges)
- **Input and crop financing** (buying of seeds, fertilisers, financing seasonal works)
 - Mostly short-term loans
 - Debtor/Asset-based financing (personal guarantees, floating charges)
 - Receivables financing (warehouse receipts, securitization)

The UNCITRAL/UNIDROIT Project on Warehouse Receipts: Introduction

The role of collateral in financing agriculture

- **General structural constraints in developing countries' banking sector**
 - Private sector credit shortage as banks maintain high share of total deposits in liquid assets (government bonds)
 - Banks' risk aversion and high debt collection and security foreclosure costs (partly also due to inefficient or outdated laws on secured transactions) leading to high collateral requirements
- **Rural sector particularly affected owing to higher default risk than in other areas of commercial lending**
 - Seasonal and erratic income streams
 - Inadequate value of land as collateral (high nominal value but unsteady cash flow)
 - Productivity loss due to climatic events (droughts, floods), pests and diseases
 - Commercial risk due to price or demand volatility

Economic functions and legal nature of warehouse receipts

Commercial use of warehouse receipts in trade and finance



(Adapted from: Wehling & Garthwaite, *Designing warehouse receipt legislation: regulatory options and recent trends*, FAO, Rome, 2015, p. 1).

Economic functions and legal nature of warehouse receipts

Commercial use of warehouse receipts in trade and finance

Warehouse receipts and crop financing

- **Increased efficiency in crop management**
 - Lowering capital investment (no need for own storage facilities) and access to post-harvest services in addition to handling and storage (cleaning, drying, grading, packaging, storing and preserving the product's quality)
 - Government regulation and supervision (licensing and insurance requirements, phytosanitary controls, liability for shortages etc.) ensures reliability and quality standards
- **Enhanced producers' access to credit**
 - Banks acceptance of warehouse receipts as asset-based collateral lowers risk of default and enhances credit terms
 - Pledge of stored goods allows producers to obtain short-term credit for working capital, crop financing or farm expansion

Economic functions and legal nature of warehouse receipts

Commercial use of warehouse receipts in trade and finance

Warehouse receipts and commodity trading

- **Improved risk management for crop marketing**
 - Warehousing helps mitigate commercial risk (seasonal or supply-driven price fluctuations) for producers
 - Producers can consolidate crops in a warehouse and sell jointly for higher prices to larger traders or processors down the value chain.
- **Expanded market access and linkages to the value chain**
 - Warehousing supports access to distant market and import/export transactions by simplifying sales and delivery in the value chain
 - Warehouse receipts may be used as delivery to settle transactions in commodity exchanges

Economic functions and legal nature of warehouse receipts

Functions of warehouse receipts in contract and property law

Warehouse receipt and the underlying contract

- **Proof of the storage contract**

- Evidence of contract terms and obligations of the parties: for the warehouse operator, to store and care for the goods and deliver them as provided in the receipt or as instructed by the depositor/holder pay the agreed storage fee and to retrieve the goods after the end of the storage period
- Incorporation of standard terms, statutory obligations and implied terms (liability for shortage, commingled goods, warranties, right of retention for unpaid storage)

- **Third party effects**

- Binding effect on the holder
- Issuer liable for misdescription or shortage

Economic functions and legal nature of warehouse receipts

Functions of warehouse receipts in contract and property law

Warehouse receipts as a negotiable instrument

- **Warehouse receipt as means of control over the goods**
 - Transfer of title
 - Constructive possession
- **Warehouse receipt as a tool for negotiating the goods**
 - Effects of transfer and endorsement and rights of the holder
 - Warehouse receipt as collateral (single and double instruments)

Objectives and challenges of modernizing and harmonizing the law of warehouse receipts

Comparative law of warehouse receipts: the continental systems

- WR often governed by **special laws** and explicitly or impliedly subject to rules **analogous to the general regime for negotiable instruments**, largely harmonized within the civil law family through the 1930 Convention providing a Uniform Law for Bills of Exchange and Promissory Notes (“Geneva Convention”), but subject to variations
 - Resulting from the particular nature of WR as a “causal” negotiable instrument;
 - Reflecting the differences between the French and Germanic (or “abstract”) systems of negotiable instruments on the protection of the holder
- Since not all civil law systems have a **general category of “documents of title”**, effect of transfer of WR on the property of the goods may vary
 - In countries where property to chattels passes by physical delivery, title to the goods passes to the new holder by endorsement of WR (“symbolic possession”) but title may pass earlier in legal systems where property to chattels passes by contract
 - Some countries permit separation of document into two pieces: one for pledging the goods (“warrant”) and another for transfer (“receipt” or “certificate”)
 - Holder generally presumed to be the lawful owner of the receipt, is entitled to claim delivery of the goods and is protected against defenses arising out of bailment contract and claims of previous holders

Objectives and challenges of modernizing and harmonizing the law of warehouse receipts

Comparative law of warehouse receipts: the traditional common law and the US model

- Warehouse receipts often governed by special laws and explicitly or impliedly subject to rules analogous to the general common law regime for negotiable instruments (**not the Geneva Convention**), but subject to variations
 - Traditional English law does not recognize warehouse receipts as negotiable instrument;
 - Most laws inspired by Uniform Commercial Code (UCC) Article 7
- UCC Article 7 includes warehouse receipt among “**documents of title**”, and expressly provides for acquisition of “rights in goods” by the transferee of the warehouse receipt
 - Protection of the transferee linked to the **doctrine of negotiation** (i.e., acquisition in good faith and “for value” in the “regular course of business or financing”)
 - A transferee to whom the receipt has not been duly negotiated, acquires the title and rights that its transferor had or had actual authority to convey
 - Warehouse receipt does not affect pre-existing rights in the goods of a person that did not authorize the deposit of the goods or the issuance of the receipt

Objectives and challenges of modernizing and harmonizing the law of warehouse receipts

Key elements of a modern warehouse receipts system

- **Custody of goods and issuance of WR and electronic receipts**
 - Care and custody obligations subject to regulatory control, insurance and default rules for shortages or other discrepancies
 - WR in recognisable format and with standardized content with default rules for missing or incorrect information
 - Recognition of electronic WR to improve trading efficiency, with adequate data security and appropriate mechanisms to ensure control by the lawful holder
- **Effective protection of the holder and efficient enforcement**
 - Law must ensure WR negotiability including pledge and endorsement of negotiable instruments
 - Purchaser of goods under WR must be able to rely on information stated in the WR and be protected against risk of inaccuracy or misdescription
 - Lawful holder must be protected against claims by previous holders and defences arising out of the relations between consignor and warehouse operator

Objectives and challenges of modernizing and harmonizing the law of warehouse receipts

Progress of the UNCITRAL/UNIDROIT Project

- Initiated in 2019 by UNCITRAL
- UNCITRAL and UNIDROIT invited multidisciplinary group of experts confirming feasibility and value of the project
- MLWR project included in 2020-2022 Work Programme as a high priority project; to be completed by Q2 2023
- Working Group of 12 leading experts plus several organizations (including IFC, FAO, UNCTAD), public and private sector stakeholders as observers
- Ongoing work: 5th Session of the Working Group in December 2022

Objectives and challenges of modernizing and harmonizing the law of warehouse receipts

Progress of the UNCITRAL/UNIDROIT Project

- Introduction of a set of black letter rules on private law aspects of WR systems
- Rules to be compatible with existing legal frameworks for WR systems and other relevant national legislation
- Rules to be a technology-neutral framework for the issuance and transfer of electronic warehouse receipts (EWRs), i.e. through electronic platforms, distributed ledger mechanisms, and other technological solutions
- Development of a guide to enactment to facilitate implementation at the country level

Objectives and challenges of modernizing and harmonizing the law of warehouse receipts

Progress of the UNCITRAL/UNIDROIT Project

- Private-law aspects of a warehouse receipt system
 - Scope of the law and definitions
 - Legal status, form (single/dual) and medium (paper/electronic) of the warehouse receipt
 - Content requirements of the receipt
 - Contractual rights and obligations of the parties, limited to the extent required by the instrument itself
 - Registration of receipts upon their issuance
 - Negotiability and transfer of warehouse receipts: sale and use as collateral
 - Amendments to warehouse receipts, including dynamic updating of EWRs
 - Substitution and removal of goods from the warehouse, and termination of storage
 - Aspects concerning creation and third-party effectiveness of a security right in warehouse receipts (and stored goods) as well as relevant priority and enforcement-related issues

The UNCITRAL/UNIDROIT Project on Warehouse Receipts

Thank you for your attention!

For more information on this project:

<https://www.unidroit.org/work-in-progress/model-law-on-warehouse-receipts/>