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 **NORTON ROSE FULBRIGHT**

# Cultivate

Food and agribusiness newsletter

Issue 12 / January 2017

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The future of the UK's agricultural  
sector post Brexit

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How will Brexit impact Africa?

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Can crop receipts help finance  
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# Cultivate

*Cultivate* delivers market insight into the global food and agribusiness sector. It is published four times a year by Norton Rose Fulbright and is available online and in print.

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## Editorial

Firstly, we are pleased to introduce Kathy Krug (Calgary, Canada) and Shane Bilardi (Melbourne, Australia), our new jointly appointed Global Food & Agribusiness co-leaders and co-editors of Cultivate.

In this, our twelfth issue of Cultivate, we focus on the possible effects of Brexit on the food and agribusiness sector. This includes analysing the EU's finalisation of the MiFID II and MiFIR packages, exploring the merger control implications of Brexit and reviewing the funding available to the UK's agricultural sector once it is no longer part of the EU's Common Agricultural Policy. We also delve into the potential implications of Brexit's impact on the UK's relationship with Africa including agricultural exports.

Other highlights in this edition include an examination of the possible introduction of pre-harvest crop receipts in Africa and a review of the numerous consumer class actions against the US sugar industry.

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## Calendar

### January

**Niterio, Brazil, January 19-20 2017**

Thirteenth International Conference on Environmental, Cultural, Economic & Social Sustainability

**Raipur, India, January 20-22 2017**

1st Asian Conference on "Water and Land Management for Food and Livelihood Security"- WLMFLS-2017

### February

**Parana, Brazil, February, 6-10 2017**

Show Rural Coopavel

**Berlin, Germany, February 8-10 2017**

Fruit Logistica

**Cape Town, South Africa, February, 15-17 2017**

Argus FMB Africa Fertilizer 2017

**Paris, France, February, 26-March 2 2017**

SIMA innovation awards

# MiFID II: EU regulators close to finalising rules for agriculture and other commodity markets

Anna Carrier

The European regulators are working to finalise the rules that will determine the scope of exemption for commodity market participants from the EU financial services legislation, and the measures on the application of position limits for commodity derivatives. The long drawn-out regulatory process is expected to be completed before the end of the year, but a number of uncertainties considering key determinants of the relevant calculation methodologies remain. With the MiFID II and MiFIR package due to become applicable on 03 January 2018, the UK referendum results are expected to have no impact, in the short to mid-term, on compliance requirements for firms in scope.

In September 2015 ESMA submitted a package of draft regulatory technical standards under MiFID II/MiFIR to the Commission for endorsement. Since then, the vast majority of draft technical standards has been endorsed by the Commission and passed to the European Parliament and the Council for obligatory scrutiny. At the time of writing of this article (early September), the only two outstanding technical standards that remain to be finalised by the Commission are those of crucial importance to the commodity market participants, i.e. the regulatory technical standards on “ancillary activity” exemption and on the methodology for setting position limits under Articles 2(4) and 57 MiFID II respectively.

Delays and political pressure have marked the adoption of the rules that will determine the whole new framework for the functioning of commodity markets. Commodity

firms that will be unable to avail themselves of ancillary activity exemption will need to get authorised as investment firms – and become subject to the whole set of existing financial services legislation, effectively meaning no hedging exemption from position limits, no thresholds for clearing obligation and compliance with stringent prudential rules. The commodity market participants have therefore long argued that the exemption has to be applied cautiously, given the existing problems around the quality and availability of data necessary to conduct relevant calculations.

Following a review period of over six months, which was in excess of the three month period foreseen in Article 10(1) of the Regulation establishing European Securities and Markets Authority (ESMA), the draft technical standards were formally sent back by the European Commission to ESMA on

20th April. The Commission demanded changes to the drafts prepared by ESMA to permit – among others – lower position limits for some agricultural commodity derivatives and a revised methodology for the “main business” assessment in the ancillary activity exemption.

On 2nd May ESMA responded to the Commission with its opinion on the proposed changes to the draft technical standard on position limits. Expressing support for most of the changes requested by the Commission, ESMA proposed to permit national competent authorities to apply position limits as low as 2.5% for derivatives with foodstuffs as an underlying. This move has been perceived by the industry as the regulators bowing to pressure from some European legislators who have been long advocating the introduction of a stringent limits regime. ESMA also proposed changes to the definition of economically equivalent OTC contracts (EEOC) and adjustments to the other months’ limits where there is a significant discrepancy between open interest and deliverable supply.

Subsequently, on 30th May ESMA passed an amended version of the draft technical standard on ancillary activity exemption back to the Commission. This version included amendments to the main business threshold, which would restrict the so-called “proxy approach” to determining the relative size of non-privileged trading activity. ESMA also provided a number of options to the Commission on a

main business assessment for the exemption based on capital, including options for calculation numerators and denominators. For the proposed numerators, ESMA suggests using the annual gross notional amount of transactions in commodity derivatives in the EU, a simplified approach derived from the Capital Requirements Regulation (CRR), using marked-to-market derivatives positions or a measure of margin or collateral. For the denominator in the calculation ESMA is considering using the figure disclosing “property, plant and equipment” of the firm’s assets or using “total equity” or the alternative financing measure from the liability side of the balance sheet. The ultimate decision as to which option, or the combination thereof, to include in the amended technical standard has been left to the Commission. Contrary to the commodity industry’s suggestions, ESMA proposed no changes to the phase in of the authorisation requirement.

Over the last few months the Commission services have been working on the technical details of the revised technical standards, focusing in particular on addressing the prevailing data availability and quality issue for ancillary activity determination. The precise timing of the adoption of the final draft technical standards remains to be confirmed, but they are now expected to be published very shortly. The exact scope of the changes introduced to the technical standards following ESMA’s proposals is also unclear. Albeit politically-motivated, changes to the technical standard on position limits seem to be rather straightforward. However, the priority issue from the industry perspective remains the calibration of the ancillary activity test. No substantive changes are expected to the trading activity thresholds, but the Commission is

expected to endorse amendments to include an alternative “main business” assessment based on capital employed. Uncertainty remains as to the calculation period.

Following the upcoming publication of the amended technical standards by the Commission, the legislators will have a three-month review period. The regulatory process for the adoption of EU position limit rules continues to generate tension among some of the legislators. The European Parliament’s left-wing political groups continue to exercise pressure on the Commission, demanding further amendments to the technical standards on position limits. Certain legislators go as far as demanding rejection of the technical standards if no additional demands are taken on-board. This autumn developments will certainly keep the industry and the regulators busy.

Finally, despite the results of the EU referendum vote, the UK’s implementation of MiFID II is in full swing. On 27th July the Financial Conduct Authority (FCA) published its second consultation paper on MiFID II implementation. The FCA cites in the first paragraph of the consultation document its statement published in the direct aftermath of the referendum in which it advised that “firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect”. In line with this business-as-usual approach, the FCA is currently consulting on a whole range of issues, including the framework for position limits and commodity derivatives reporting.

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# UK's agricultural sector given time to gather its thoughts prior to 'Brexit'

Vanessa Brierley

In June 2016, 51.9 per cent of citizens in the United Kingdom (UK) voted in favour of leaving the European Union (EU). The effects of the referendum have been swiftly felt as the pound dropped to its lowest value since 1985, having ramifications in almost every sector. Agriculture is one sector which will face certain disruption for some time yet – by leaving the EU the UK will no longer be part of the EU's Common Agricultural Policy (CAP). Chancellor Philip Hammond's recent announcement that the government will match the current level of agricultural funding budgeted under the CAP until 2020 has provided some respite, however, what form and level of support the government will provide following the UK's exit and the impact of any new policy is yet to be determined.

## What is the CAP?

The CAP came into operation in 1962 to increase agricultural productivity so that consumers would have a secure supply of quality and affordable food and ensure that those dependent on agriculture are able to make a reasonable living. Despite undergoing a series of reforms to meet changing economic conditions since then, it remains one of the most significant EU financial commitments, accounting for just under 40 per cent of the EU's total budget.

Today the CAP comprises two separate 'pillars'. Pillar 1 (also known as the basic payment scheme) provides direct payments to farmers, in the form of a basic income support. Pillar 2 provides EU funding to governments for rural development programmes (including projects which support the wider rural economy, such as rural tourism), which governments are required to match. The UK receives more than £3 billion each year in subsidies under the CAP and many farmers rely on this to break even.

## Is the current system effective?

The CAP policy has successfully achieved many of its goals - it gives the EU food security, promotes quality and diverse produce and increasingly is used to protect rural communities and the environment. However, there are a number of elements that are unpopular. For example:

- the CAP is said to lead to overproduction and waste, by ignoring supply and demand market forces;
- the majority of funds are said to go to a minority of (predominantly large) farms, leaving the system unbalanced;
- UK farmers would like less regulation imposed, including (controversially) in respect of pesticide use;
- it is preferable to incentivise 'good farming' and land use, which benefits society and the environment;

- farmers receive a large proportion of the EU's total budget, while representing a small portion of the population.

As a result of 'Brexit' the UK will have a real opportunity to address these perceived failings as well as the broader issues of trade, immigration (including the large number of foreign workers the sector employs), environmental aspects and animal welfare, to create a comprehensive system that meets the UK's needs today and into the future.

## What is the way forward?

In the short term little is expected to change. The government's announcement that it will match the amount of funding expected under the CAP to 2020 buys it valuable time, although the UK's exit is not expected to take effect until 2019 anyway. The World Trade Organisation is expected to have some influence on any new policies and farmers, food producers and environmental groups will all seek to lobby the government for their preferred system of subsidies and regulation. Going forward, it is



impossible to know what shape or form of policies and subsidies, the government may implement as the UK's exit strategy and negotiations develop.

Some commentators suggest that farming subsidies should be eliminated altogether, allowing market forces to determine productivity and competitiveness. This has proven a positive move for other nations in the past. Faced with a budget crisis, New Zealand's government repealed nearly all of the country's farm subsidies in 1984. While their agricultural sector unarguably faced a tough period, few of the country's full time farmers went under. Left to rely on consumer demand, the entire agri-business supply chain became more efficient, innovative and competitive and the land benefited with a decline in pesticide use, soil erosion and overstocking.

Given the strategic importance of agri-business in the UK and the UK's significant food-processing industry which relies on raw agricultural product, it seems unlikely the government would take this approach, however, it cannot be assumed that the UK government will continue to subsidise farmers to current levels either. The government has previously stated its belief that the current Pillar 1 payments distort the market and place an unjustifiable burden on spending so it is possible these payments may not continue in their current form. Pillar 2 provisions, which seek to address environmental and conservational aspects may, however, continue or even increase under a policy which incentivises environmentalism and rural tourism.

Whatever the approach, it is hoped that the UK can seize this opportunity to

introduce an effective domestic policy which will address current concerns, protects the environment, supports rural communities and gives the agricultural sector the tools it needs to continue to compete on the global stage.

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# No sweet talk

Stephen J. Riccardulli and Sonia H. Lee

**Food manufacturers are being accused of manipulating scientific research and improperly influencing the national scientific debate over the relative health risks of sugar, despite the purportedly known risks to public health at large, all to benefit their business operations.**

For example, a study recently published in the *Journal of American Medical Association*<sup>1</sup> asserts that for over 50 years the sugar industry downplayed sugar's possible role in cardiovascular disease while demonizing the hazards of fat, despite knowing the potential health dangers associated with sugar. The blame is levied not only on industry-sponsored studies, but also on the industry's "corporate speech" – i.e., public statements concerning the studies and the link between health effects and sugar. The United States Food & Drug Administration's new sugar labeling requirement, unveiled earlier this year, only adds fuel to the fire over the sugar controversy. It is against this backdrop that we are now seeing an emerging trend in significant class action lawsuits targeting companies in the sugar industry.

## The United States Food & Drug Administration's new sugar labeling requirements: Sugar is the "new enemy"

On May 20, 2016, the United States Food & Drug Administration ("FDA") finalized new "Nutrition Facts" labeling requirements for packaged foods, which

is aimed at helping consumers make better-informed food choices. FDA promulgated changes to the Nutrition Facts labeling requirements based upon new scientific information, updated nutrition and public health research, recent dietary recommendations from expert groups, and public input. One of the new requirements is that food manufacturers disclose any "Added Sugars"<sup>2</sup> in both grams and as a "percentage of Daily Value" in the Nutrition Facts label.

FDA's changes to the sugar labeling requirements comes after years of debate over the potential health effects of excessive sugar consumption. That debate, which has recently shifted towards an anti-sugar narrative, culminated in the above-referenced September 2016 study published by the *Journal of American Medical Association* (the "JAMA Study"), wherein researchers found that in the 1950s and 1960s the sugar industry – through a trade association, the Sugar Research Foundation ("SRF") – sought to downplay sucrose's role

in causing coronary heart disease and other nutritional risks by casting doubt on studies finding a link between the two. More specifically, the JAMA Study concluded that "the sugar industry sponsored its first [cardiovascular disease] research project in 1965 to downplay early warning signals that sucrose consumption was a risk factor in [cardiovascular disease]."<sup>3</sup>

According to the JAMA Study, in 1965, the sugar industry-funded SRF sponsored a research project, which entailed Harvard scientists conducting a literature review of various studies and experiments on sugar. Their results were published in 1967 in the *New England Journal of Medicine* (the "NEMA Study"), and the NEMA Study stated that there were major problems with all of the prior studies and experiments that implicated sugar. It concluded that cutting out fat from American diets – not sugar – was the way to combat coronary heart disease. Consistent with the conflict-of-interest rules that applied in 1967, the NEMA Study's source of funding was not disclosed when it was published. It is this lack of transparency, coupled with the sugar industry's influence on public discourse on health, that has now been deemed manipulative and disingenuous, at best; and legally culpable, at worst.

## Consumer class actions against the sugar industry

The sugar industry and certain food producers are now the subject of significant consumer class actions which are the logical extension of the JAMA Study and others like it. They include similar allegations – i.e., food manufacturers knew that sugar was linked to cardiovascular disease and other potential ailments, but cast doubt on studies finding a link between the two by funding studies designed to downplay the health effects of excessive sugar consumption – and

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<sup>1</sup> Kearns, C.E., et al., "Sugar Industry and Coronary Heart Disease Research," *Journal of American Medical Association Internal Medicine* (Published Online Sept. 12, 2016), hereinafter the "JAMA Study".

<sup>2</sup> FDA defines "Added Sugars" to include sugars that are either added during the processing of foods or are packaged as such. For a technical definition of Added Sugars, food manufacturers are encouraged to consult page 33980 of FDA's Nutrition Facts Label Final Rule, available at <https://www.gpo.gov/fdsys/pkg/FR-2016-05-27/pdf/2016-11867.pdf>.

<sup>3</sup> The JAMA Study also suggested that "[p]olicymaking committees should consider giving less weight to food industry-funded studies[.]"



then publicly touted these studies in the form of corporate speech. Indeed, the underlying theme in all of these lawsuits is that the food manufacturers sought to control the public record on sugar and convince the public at large that sugar consumption is not linked to health ailments. Accordingly, consumers' claims turn on the sugar industry's alleged misleading marketing of industry-funded science on sugar, and include, inter alia, false and deceptive advertising claims under state consumer protection statutes (including, notably, California's Unfair Competition Law and False Advertising Law), and unfair competition claims under state law. While most states' laws allow plaintiffs to recover actual losses as damages, it is possible that plaintiffs could also seek restitution – i.e., the return of the price the consumer paid for the product.

### Potential challenges and recommended strategies for defending claims

The “fraud against the public” narrative underlying these consumer class actions is not uncommon, and proceeds along similar lines – i.e., the industry influenced the science, and/or the industry knowingly misled the government and public alike. Indeed, in recent years, mass tort plaintiffs in other contexts have alleged that companies, despite having knowledge of the dangers associated with a certain product, sought to influence the scientific record – and, as a result, the public at large – to better position themselves in the marketplace.

For example, in recent litigation involving the alleged health effects associated with exposure to polychlorinated biphenyl (“PCBs”), the plaintiffs alleged that the manufacturer knew human exposure to PCBs could have harmful effects, but for years manipulated the scientific and public record related to PCBs through press releases and other literature to promote the results of favorable studies, while “casting doubt” on any studies

claiming a link between exposure to PCBs and injury to human health. Similarly, a petroleum company's alleged knowledge of the link between fossil fuels and climate change is currently being litigated, and, again, the focus is on the company's corporate speech – i.e., whether, despite knowledge to the contrary, the company publicly continued to downplay the role of fossil fuels by funding studies designed to result in favorable findings, publicly endorsed such favorable findings, and criticized those studies that resulted in adverse findings.

In each of these settings, the companies' statements are being used to establish a pattern and practice of “controlling” the dialogue regarding the relevant science so as to manipulate the public/scientific record in a favorable way. This suggestion of a pattern and practice could be more important to a jury than the validity of the company's statements.

When defending such claims, food corporations should thus emphasize to the jury that corporate speech must be evaluated in the context in which it was made. Plaintiffs will certainly rely on public statements of the company in prosecuting their action, but some of these corporate statements were made decades ago, when the scientific and cultural landscapes were very different. For example, the JAMA Study accuses the sugar industry of manipulating the scientific dialogue by not disclosing the source of funding for the NEMA study. The JAMA study fails to acknowledge that in 1967 the rules regarding funding disclosures were such that many studies did not disclose funding information. By placing the various statements back into the proper context, defendants can often neutralize any suggestion of impropriety.

Another tactic often used by plaintiffs is their reliance on so called “historians” who offer “expert testimony” regarding both the history of a corporation's public statements and the resulting

analysis regarding the intent behind the various statements. The use of such “historian” experts is subject to attack. Indeed, some courts have wholesale precluded this type of purported expert testimony, recognizing that the testimony is little more than an recitation of corporate statements without any analysis that would aid the court or the jury. Other courts have substantially limited the scope of such expert testimony by allowing the historian to testify as to the contents of the corporate speech, but barring any testimony regarding the corporation's intent behind the corporate speech.

Finally, whether the public statements made by food manufacturers are protected speech under the First Amendment – including a company's right to lobby – is likely to be a significant point of contention in these suits. The sugar industry and food producers will almost certainly, and should, assert First Amendment defenses, including the Knoerr-Pennington doctrine, but the nature of the communication may ultimately be a jury determination upon which these defenses will prevail or fail.

In sum, whether industry-sponsored research and corporate speech can form the predicate for liability is yet to be determined. What is clear, however, is that a focus of the litigation will be on the public statements of the company – some made decades ago when the scientific understanding and standards regarding funding disclosure, transparency, and study design were different from those that exist today. Even more clear is the fact that food companies are at risk of being subjected to lawsuits based upon such prior statements.

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# Implications of Brexit: the possible impacts and opportunities for Africa

Lisa Koch

The outcome of the UK referendum to leave the EU (Brexit) shocked global markets and launched the UK into a realm of political and economic uncertainty. This uncertainty will likely linger for a while, as the UK decides how it will conduct itself in its post-Brexit world. In this environment, investors operating on the African continent are trying to answer a complex and important question: how will Brexit impact Africa?

## Aid

The UK has pledged 0.7% of its Gross National Income (GNI) as development aid, a significant portion of which is earmarked for development in African nations. Depending on the political focus of Westminster after a new leader of the conservative party is selected, UK aid contributions may be slashed. Even if contributions are not cut for political reasons, they may be cut due to the impact Brexit has on the UK economy. If Brexit causes a recession (as many economists have predicted) the UK's GNI will fall, which will lead to decreases in foreign aid. It is expected that nations such as Sierra Leone and South Sudan will suffer the most, as recent figures suggest that UK Aid represents 4.4% and 1.5% of each country's respective GDP. By way of comparison, UK aid represents only 0.04% of Nigeria's GDP. A fall in aid will likely hinder the abilities of aid-dependant nations to push forward with development initiatives.

## Foreign Direct Investment

This uncertainty also increases the risk of certain African nations seeing foreign direct investment from UK entities fall. If the UK goes into a recession, it is unlikely that UK entities will have the appetite to increase investment in Africa. According to the IMF's Coordinated Direct Investment Survey (CDIS), the UK is amongst the top five economies providing inward investment into Uganda, Zambia, Botswana, and Nigeria. Of these nations, UK FDI makes up the highest percentage of GDP in Zambia, making it the most likely to feel the effects of a decrease in investment from the UK.

## Trade

Trade is an area where there is potential for significant change in a relatively short time. Figures from the Office for National Statistics (ONS) show that African exports to the UK account for approximately 4.8% of total African exports. This may not appear to be a

substantial figure, considering that China accounts for approximately 15% of Sub-Saharan African exports. However, the UK leaving the EU may significantly impact certain African economies in the short term. For example, Kenya exports a significant percentage of its flowers to the UK. Consequently, Kenyan flower exporters would have to absorb any losses caused by a contraction in the UK economy triggered by Brexit, and will be concerned by the uncertainty surrounding the basis on which they will trade.

Brexit provides a unique opportunity for African nations to join together (perhaps by using the regional African trading blocs) to leverage their position and collective bargaining power to negotiate more advantageous trade deals. There have been suggestions that the UK should forge closer links with the Commonwealth nations, including respected African economies such as South Africa, Ghana and Nigeria. South Africa and Nigeria (Africa's two largest economies) have their own share of political uncertainty, however if these economies can effectively negotiate together, they may well end up with more beneficial trade terms.

The manner in which the UK will approach negotiations with African nations is still to be seen, however, it is clear that agriculture will be a main topic of discussion. The EU's Common Agricultural Policy (CAP)

which heavily subsidises EU farmers and in turn, negatively affects the competitiveness of African farmers, has been criticised. On this issue, African nations are likely to find themselves in a better bargaining position against both an isolated UK, and an EU offering a single market reduced by the UK's absence. Tanzania has already taken the first step in announcing that it will not sign the proposed Economic Partnership Agreement between the EU and the East Africa Community, in the belief that it can achieve a better deal following Brexit. African nations will do their best to negotiate the removal of any limitation on the ability of African farmers to export their produce, particularly as agriculture is one of the key ways African are seeking to diversify their export base.

The full impact of Brexit on Africa is yet to be seen, uncertainty is likely to linger for a while, and the nations that are highly dependent on the UK are more likely to scramble to take whatever deal the UK offers. Nonetheless, Brexit provides a unique opportunity for African nations to flex their collective political muscles and negotiate more advantageous trade deals, and it should not be missed.

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Lisa Koch is a senior associate in our London office



# How can crop receipts help finance African agriculture?

Keith Mukami

Norton Rose Fulbright is to advise the International Finance Corporation (IFC) and the Food and Agriculture Organization of the United Nations (FAO) on a feasibility study relating to the introduction of pre harvest crop receipts in Africa using Zambia and Uganda as pilot jurisdictions.

## Farmer fragmentation and the introduction of crop receipts

The fragmentation of African (and other farmers) is well documented. Various reasons account for this, not least the inability of farmers to source financing particularly at pre harvest time when they desperately require financing to purchase inputs such as seeds, fertilizer, machinery and so forth.

Crop receipts are a pre-harvest financing instrument issued by producers that are collateralised against the crops under production. They are promissory notes to deliver a certain quantity and quality of agricultural produce at a defined future date. By purchasing the crop receipt, the buyer pre-finances the production of the crop and is repaid at the delivery or expiry date of the receipt. Crop receipts can be issued by farmers, cooperatives or agro-processors and purchased by input suppliers, off-takers, banks or financial investors.

Crop receipts can have three main functions:

- They can serve as a collateral substitute complementing or substituting other forms of collateral used by agricultural producers to obtain finance,
- They can allow new actors to finance agricultural production (e.g. financial investors/capital markets, agribusiness)
- They can enhance the liquidity of pre-harvest financiers through securitization and secondary markets, based on the crop receipt as the underlying.
- There are two basic types of crop receipts:
- Physical crop receipt: A promissory note by a producer to deliver a specified quantity of commodity, of specified quality, at a specified location, on a given date.

- Financial crop receipt: A promissory note by a producer to deliver the cash equivalent value of a specified quantity of commodity, of specified quality, on a given date – two variants:

- Fixed price variant: the repayment amount is set in advance;
- Indexed price variant: the repayment amount is indexed against a commodity price that prevails on the specified date.

## Brazil and the revolution of agri-financing using crop receipts

To date crop receipts have been used only in a handful of jurisdictions as a mainstream way of raising agri financing. The main success story has been in Brazil, although recently FAO, IFC, and European Bank for Reconstruction and Development have worked to replicate the instrument in Eastern Europe (notably the Ukraine and Serbia).

In Brazil, the crop receipt was introduced in 1994, driven by a leading public sector bank, Banco do Brazil, and has been scaled to annual sums in the USD billions. Commodities that are financed in this manner include traditional high value export commodities such as soya bean, coffee, cotton, sugar and livestock, but also lower value commodities including

rice, beans, milk, potato and coconut, as well as specialist commodities including various forms of timber.

Crop receipt issuers tend to be mainly medium-to-large commercial farmers and producer cooperatives. Due to the nature of the transaction costs, they do not tend to be issued directly by smallholder farmers but could be issued on their behalf by aggregators such as cooperatives

Crop receipts are registered in one of two collateral registries; enforced through fast track judicial processes; offered by producers for auction through the customised platforms of the Banco do Brazil, or through the general commodity exchange, the Brazilian Commodity Exchange (BMM); and packaged as securities issued to capital market investors under rating from the credit ratings agencies, such as Moody's.

The successful introduction of crop receipts and their acceptance in the market has been supported by several key factors including:

- Customised legal framework – legislation that uphold the rights and obligations of the parties, especially in the event of non-performance and allows for speedy enforcement.
- Strong support by Banco do Brazil, the largest commercial bank with majority shareholding of the Government of Brazil – through and auction floor supported by partial guarantee mechanisms;
- Enabling institutional and market framework - including well-organised value chains, commodity exchanges for price determination and hedging and two centralised collateral registries at the commodity exchanges;

- Monitoring mechanisms – agricultural service providers, often divisions of existing organisations such as input or equipment suppliers, financiers, collateral managers or NGOs, provide monitoring services for the crops in the ground;
- Negotiability of the instrument so as to be traded from party to party on a commodity exchange, enabling agribusiness or financiers to tailor and manage exposures;
- Incentives, such as exemptions from the financial transaction tax and access to some subsidised credit lines
- Securitization instruments that enable agribusiness to manage their liquidity based on the crop receipts that have been issued to them – i.e. a financing channel for agribusiness that enables them to obtain more funding that can be passed on to farmers/cooperatives.

The crop receipt in Brazil is not the only source of finance for producers – it complements an array of other financing instruments, some with similar features as well as more conventional ones. Therefore, the crop receipt is not seen as the panacea for pre-harvest finance, but rather one additional choice that producers have to increase, tailor or diversify their financing options.

### How can crop receipts help finance African agriculture?

Given its success in Brazil the IFC, FAO together with NRF has embarked on an exciting project to see whether similar forms of financing could be introduced in the African environment. Crop receipts could help farmers to access additional, timely sources of finance for inputs, with repayment terms

shaped according to the needs of the agricultural cycle.

In particular, crop receipts can help to address the pervasive collateral constraints in the rural economy by providing financiers with an additional security instrument which can be readily evaluated, perfected and enforced, and can provide them greater comfort to finance the sector.

They also allow agricultural producers and value chain actors to tap into diverse sources of finance beyond banks, including capital markets through financial and commodity exchanges and “over the counter”. Financial investors might be interested in crop receipts, or securities issued on the back of crop receipts, to provide new alternatives for portfolio diversification.

From the perspective of agribusiness and financiers, the legal protections, monitoring mechanisms and liquidity management instruments associated with the regime for crop receipts provide a secure means of more efficiently integrating value chains and financing the agricultural sector.

At present, the pre-harvest financing that exists in Africa tends to be unsecured based on value chain relationships, bringing higher costs and risks – performance risk, price risk, risk of side-selling – which reduce or deter the potential flow of finance to the sector, and in particular the smaller players which may not otherwise have access to finance through the mainstream banking channels.

Crop receipts could help to mitigate or overcome these challenges, especially if accompanied by an enabling legal, regulatory and institutional framework. Crop receipts are a more standardised legal instrument linking commodity



and financial markets that can be used in various ways, including (i) for barter transactions between value chain players substituting prepaid forward contracts, (ii) as an alternative to pre-harvest credit for banks allowing for rapid out of court settlement, (iii) as additional collateral backing credit contracts, (iv) as basis for securitisation. This instrument would constitute an alternative to bank loans and to unsecured pre-harvest financing that typically takes place through contract farming today, thereby enhancing the availability of pre-harvest financing and/or reducing its costs.

### How is the Africa Crop Receipts Initiative working to implement crop receipts in Africa?

The Africa Crop Receipts Initiative is being developed in two phases:

- 01 | Background research on key success factors and enabling conditions;
- 02 | Pre-feasibility studies in two sub-Saharan African countries (Zambia and Uganda);

Subject to the outcome of these assessments, IFC may be interested in supporting the introduction of crop receipts on a pilot basis as well as potential follow-up activities.

Background research has so far focused on identifying the preconditions for introducing crop receipts on a continental level in sub-Saharan Africa, taking into account key lessons from Brazil and Eastern Europe, but also bearing in mind relevant differences in the respective contexts, and in particular by defining the success

factors that can drive scalability and inclusiveness.

There are significant differences between the Brazilian agri economy and those that exist in Africa. This is well understood by the parties involved in this project. For this reason initially the project will centre around creating an exploratory framework to assess first whether there is need and opportunity for crop receipts in the African context, and if so, secondly, how crop receipts can be adapted and customised to work in African jurisdictions.

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# Brexit: merger review implications and recommendations

Jay Modrall and Ian Giles

**The United Kingdom’s vote to leave the European Union – known as Brexit – triggered a political and economic earthquake whose political and economic consequences continue to make daily headlines, almost five months later.**

Although the long-term consequences of Brexit will not become clear for many years, one antitrust-related consequence will be of particular interest to multinational businesses: elimination of the “one-stop-shop” of the European Union’s Regulation 139/2004 on the control of concentrations among undertakings (the EUMR).<sup>1</sup>

Under the current system, a Brussels filing precludes the need to file in the United Kingdom. In future, many transactions that are notified under the EUMR will also be notified to the UK Competition and Markets Authority (CMA). This duplication of notification requirements will increase the already significant burdens for companies engaged in mergers or acquisitions, who will have to make parallel filings in Brussels and London. The burden of duplicate merger notifications will be particularly significant in major strategic transactions in the agricultural sector, such as Bayer/Monsanto, ChemChina/Syngenta, and Dow/DuPont, which may involve multiple markets and complex vertical and joint venture relationships.

In this article, we explore the merger control implications of Brexit in more detail and offer some preliminary suggestions of ways to mitigate the burden on competition authorities and business.

## Background

The basic mechanism for an EU Member State to leave the European Union is set out in Article 50 of the Treaty on the European Union (TEU), but the language of this article is very general.<sup>2</sup> The Article 50 process is triggered by a notice from the leaving Member State to the European Council. Once the notice is given, the departing State has two years to negotiate an exit agreement, failing which its exit becomes effective automatically. The complexity of the issues involved makes it highly unlikely that an agreement can be reached in less than two years.

Prime Minister Theresa May has said that the UK will give this notice by March 2017, so the effective date for the United Kingdom’s exit from the European Union will likely be around March 2019. In addition to the exit agreement, the UK and the

EU will need to negotiate a more comprehensive agreement to govern their future relationship, such as a customs union or free trade agreement. While the exit agreement can be approved by a qualified majority vote in the European Council, the future comprehensive agreement will likely need to be approved unanimously and ratified by each remaining EU Member State, a process that could drag on for many years.

The broader consequences of Brexit and the future relationship between the EU and the UK are beyond the scope of this article. For present purposes, however, it seems reasonable to assume that as from March 2019 EU merger notifications will no longer cover the UK. As a result, parties to M&A transactions triggering the EUMR thresholds will also have to consider the application of the UK merger regime, which is structured very differently.

The key difference between the EU and UK systems lies in which mergers are caught in the first place. The UK system captures “relevant merger situations” where the target has turnover above £70 million, or the combined market share of the parties on any plausible market definition is twenty-five percent or more. In those situations, parties can decide whether or not to notify the CMA. In practice, parties who meet the test are well-advised to inform the CMA, even if by an informal letter explaining why the parties do not intend to notify formally. The CMA can, wherever a relevant merger situation

<sup>1</sup> Council Regulation (EC) No 139/2004 of January 20, 2004 on the Control of Concentrations between Undertakings.

<sup>2</sup> Article 50 of the TEU, available at <http://www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-European-union-and-comments/title-6-final-provisions/137-article-50.html>

occurs, call in a merger for review. By contrast, if a deal meets the EU notification thresholds – which are currently entirely turnover-based<sup>3</sup> – an EU notification is mandatory. Moreover, the parties cannot close a deal until EU clearance has been obtained: in the United Kingdom, it is legal to close a deal qualifying as a relevant merger situation, although the CMA will likely require the parties in a case that the CMA is investigating to hold their businesses separate until a decision has been reached.

The differences between the thresholds affect the types of mergers reviewed by each authority. For example, under the EUMR so-called “full function joint ventures” may be notifiable based on the parent companies’ turnover even where the joint venture itself is small and has little or no presence in the EU and/or where there is no overlap in the parties’ activities. Cases of this nature are not caught under the UK rules.

These structural differences are reflected in the outcomes of cases reviewed under the UK and EU systems. The CMA conducts in-depth investigations in a much higher percentage of transactions, reflecting the fact that the CMA’s case load includes a higher proportion of difficult cases, as routine cases presenting no serious issues cases are often not notified. Similarly, a far larger proportion of CMA decisions require remedies or commitments to resolve competition concerns than is the case in Brussels. Because the CMA’s cases are more difficult, on the whole, the CMA has a number of different processes from the Commission:

- The CMA can fast-track cases straight to the in-depth Phase 2

review, where it is clear that the deal could not be cleared in Phase 1.<sup>4</sup>

- The CMA has no “short form” notification procedure. At the EU level, parties to deals that on their face raise no concerns can use the less onerous “Short Form CO,” an abbreviated version of the full Form CO used for notifying transactions under the EUMR. Indeed, the Commission even exempts notifying parties from complying with all aspects of the Short Form CO in the most straightforward cases.
- The CMA’s Phase 1 review lasts forty working days, compared to the Commission’s twenty-five. The CMA’s longer review period may be off-set, however, by the Commission’s practice of engaging in (sometimes lengthy) pre-notification discussions, which take place before the Commission accepts the notification as complete. In essence, this allows the Commission to extend the review process outside the statutory timetable.

Finally, the United Kingdom retains a narrow role for public interest factors like national security, plurality of the media and preserving stability of financial markets, but Theresa May has suggested that UK merger review should take more account of “industrial strategy.” By contrast, the EU regime carves out public interest factors as an issue for Member States and so there is (at least in theory) no scope for policy issues to intrude on EUMR reviews.

### Brexit Consequences for Merger Control

The elimination of the UK from the EUMR one-stop-shop can be expected to lead to a significant increase in

the number of UK filings post-Brexit, though not all transactions notified in the EU will also be notified in the UK.

While many if not most transactions that meet the EU thresholds are also likely to meet the UK thresholds, although transactions clearly raising no competition issues, like many private equity transactions, will probably not need to be notified in the United Kingdom. Moreover, some transactions having a “Union dimension” under the EUMR may not meet the UK test. For instance, joint ventures that meet the EU turnover thresholds by virtue of the parents’ turnover are not necessarily captured under the UK rules. In addition, many deals that meet the EU thresholds will not trigger the UK thresholds, because the target does not have more than £70m in UK turnover and the transaction does not involve the creation or increase of a twenty-five percent share of supply in the United Kingdom.

Conversely, Brexit may lead to a slight reduction in the number of EU filings. Many companies derive a significant portion of their EU turnover in the United Kingdom, and some transactions that would currently be notifiable under the EUMR will likely not meet the turnover thresholds for mandatory filing when the United Kingdom is excluded. Perhaps more significantly the number of EU filings made pursuant to a voluntary referral request may be reduced. Under the EUMR, parties acquiring control in transactions that would otherwise be notifiable in three or more Member States can request that the transaction be referred to the Commission for review. The United Kingdom’s jurisdictional thresholds are broad, and it is not uncommon for the United Kingdom to count as one of the jurisdictions that can be used to trigger a referral request. The parties to

<sup>3</sup> EUMR, Article 1(2) & (3). The European Commission is currently consulting on the possible introduction of a deal-size threshold, which may be in effect by 2019.

<sup>4</sup> This fast track process was first used in Thomas Cook/Co-op/Midlands Co-operative Society Thomas Cook/Co-op/Midlands Co-operative Society Merger Inquiry (CC) August 16, 2011.



transactions that would be subject to review in only three EU Member States, one of which is the United Kingdom, would no longer be able to take advantage of the referral process.

Overall, while it is not possible to predict with any accuracy the likely effect on the number of EU merger filings based on data published by the Commission, it seems likely that Brexit will result in a small but noticeable drop in the number of filings to Brussels.

### **Divergent outcomes and resulting burden on businesses**

One theoretical possibility that will raise material concerns for business is the increased possibility of concurrent reviews in London and Brussels leading to divergent outcomes (i.e., one authority clearing a merger and the other blocking it) and/or of differing, inconsistent remedies. A recent example of such divergent outcomes involved Eurotunnel's acquisition of the bankrupt SeaFrance ferry operation, which was approved by the French authorities but blocked by the United Kingdom.<sup>5</sup>

Currently, Section 60 of the UK Competition Act 1998 contains a "convergence clause" to ensure the compatibility of UK competition law with EU competition law. Post-Brexit, there will be no legal need for such a clause, and it might be removed from UK law. Removal of the convergence clause would increase the likelihood of the CMA's approach diverging from the Commission's in specific cases, although both authorities will presumably strive to avoid such divergent outcomes.

### **Elimination from the European Competition Network**

Another significant consequence of Brexit would be the removal of the CMA from the European Competition Network (ECN), which includes the Commission and EU Member State competition authorities. Two notable advantages of the ECN are (i) close co-operation and consistency among national competition authorities such as the CMA and (ii) a flexible and informal case allocation system. Leaving the ECN will mean this close cooperation and consistency will be lost, with, importantly, both the CMA and the other national authorities losing out.

In summary, Brexit may somewhat reduce the number of EU filings, but Brexit will likely lead to a significant increase in the number of UK notifications. The duplication of work and the risk of divergent timetables and (potentially) outcomes will impose significant additional costs on businesses and (in some cases) increase legal uncertainty for business.

### **Mitigating the "Brexit Tax" in Merger Review**

Although Brexit seems likely to increase the burdens of the merger review process and in some cases to increase legal uncertainty, there are some concrete steps that could be taken to mitigate these negative consequences. Some of these steps are discussed below.

One key step that the Commission and the CMA can and, in our view, should take is to create an ad hoc framework for cooperation in merger cases. This framework should provide for close cooperation between the Commission and the CMA in cases notified to both jurisdictions, beginning well before the Commission's existing procedures for consulting EU Member State authorities

on proposed merger decisions. To reduce the duplication of effort for themselves and for businesses, for example, the Commission and the CMA could consult on the information to be included in a complete notification.

The CMA could also agree that it would accept EU notifications (with some supplemental UK-specific information) for UK purposes. The Swiss competition authority already follows such an approach in respect of transactions that have also been filed in Brussels.

Similarly, the Commission and the CMA could cooperate in the collection of evidence. For instance, they could prepare common questionnaires, cooperate in interviews with customers and competitors, and conduct site visits and state-of-play meetings jointly. The U.S. and Canadian authorities embrace such practices to facilitate their parallel merger reviews.

In each of these cases, the parties' rights of defense would need to be protected, but merging parties would benefit from close cooperation in many if not most cases.

In the relatively small percentage of cases raising substantive issues, cooperation may be more challenging, but offer even greater potential efficiencies. If the recipients of an EU statement of objections wished to exercise their right to an oral hearing, for example, the hearing could be coordinated with the CMA – or, perhaps more realistically, the CMA could consult closely with the Commission and adjust its review timelines to allow the EU and UK processes to move forward in parallel and align key decision points. As noted, the current UK process is forty working days in Phase 1 in comparison to twenty-five working days in Brussels, which will mean the Commission may have had to conclude on whether to open a

<sup>5</sup> CMA Update of January 20, 2016 in Eurotunnel / SeaFrance Merger Inquiry, <https://www.gov.uk/cma-cases/eurotunnel-seafrance-merger-inquiry>

Phase 2 investigation before the CMA has reached the same point. It would be in the interests of all parties if such decision making could be better aligned.

Where the parties wish or are required to submit remedies to obtain merger clearance, the Commission and the CMA could agree to accept remedy proposals in the same format, if and to the extent the issues are the same. The Commission and the CMA could also agree to cooperate in the market testing of proposed remedies. Similarly, in remedy implementation the Commission and the CMA could agree to accept the same forms and otherwise avoid duplication. For example, in many cases only one monitoring or divestiture trustee should be required for both the EU and UK processes.

In many cases, we anticipate that it would make sense for the CMA to rely on the Commission's existing precedents and procedures. A useful model might be the existing arrangements under which the Canadian Competition Bureau sometimes relies on remedies negotiated by the U.S. agencies based on a side letter, without the need for a complete separate remedy process in Canada.

### Conclusion

In summary, Brexit will likely lead to duplicate EU and UK notifications in many transactions that meet the EUMR thresholds. The additional notification requirements will very

likely lead to increased costs and complexity for business and may put a strain on the CMA's resources. With creativity and good will, however, the Commission and the CMA could do much to mitigate these burdens. In many cases, the Commission and the CMA could potentially make significant improvements through bilateral agreements without the need for new legislation.

It remains to be seen how far the CMA will be prepared to accept the Commission as the "lead authority" on European competition matters. The CMA may be less willing to allow another agency to take a leading role than the Swiss and Canadian authorities have been. If that turns out to be the case, a looser structure in which the Commission and the CMA could agree on a case-by-case basis which authority is best placed to take the leading role may be preferable.

Although the structure and contents of the broader Brexit negotiations are likely to be unclear for some time, we encourage the Commission and the CMA to consider potential steps and to set up working groups to discuss these initiatives in parallel with or potentially even before the commencement of the broader negotiations.

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## Food safety

Bernard O'Shea and Rohan Sridhar

### Australia: Regulator considers permitting the sale of food derived from low THC hemp seeds

Food Standards Australia New Zealand (FSANZ) is calling for submissions in response to its draft variation of the Food Standards Code that would permit the sale of foods derived from low tetrahydrocannabinol (THC) hemp. The proposal follows a request by the Australia and New Zealand Ministerial Forum on Food Regulation (Forum) for FSANZ to consider how THC could be legally designated as food.

Presently, the Food Standards Code (Code) prohibits the inclusion of cannabis or derivatives in food products in Australia. The position is the same in New Zealand, save for hemp seed oil, which can be sold as a food product.

FSANZ's proposed variation to the Code would allow for the sale of foods containing low THC Cannabis sativa seeds, as long as the seeds are non-viable and hulled, and contain no more than 5 mg of THC per kilogram of seeds. The sale of food containing the following products would also be permitted:

- Oil extracted from the seeds of low THC Cannabis sativa, if the oil contains not more than 10 mg of THC per kilogram of oil;
- A beverage derived from seeds of low THC Cannabis sativa, if the beverage contains not more than 0.2 mg of THC per kilogram of beverage;
- Any other substance that is extracted or derived from seeds of low THC Cannabis sativa and contains not more than 5 mg of THC per kilogram of the relevant substance.

In recommending an amendment to the Food Standards Code, FSANZ found that low THC hemp seeds do not present a public health and safety risk. FSANZ also noted that low THC hemp seeds are nutritionally dense, including being a source of omega-3 and polyunsaturated fatty acids.

The Forum requested FSANZ to provide policy advice about restricting the advertising of low THC hemp, particularly the use of cannabis leaf imagery and claims of psychoactive effects or links to illicit cannabis. FSANZ concluded that imposing advertising restrictions in the Code would not be appropriate, pointing to the lack of supporting research, the existing consumer law (eg, misleading or deceptive conduct provisions) and the experience in foreign jurisdictions. FSANZ also noted the possibility of additional legislative prohibitions on advertising in which it is claimed that hemp food products have psychoactive qualities, which would exist outside the Food Standards Code.

FSANZ also considered whether it is necessary to impose a limit on cannabidiol (CBD), in order to distinguish food products from therapeutic goods. FSANZ concluded that imposing a CBD limit is not necessary, as a person would need to consume 24kg of hemp seeds per day to constitute a therapeutic dose – orders of magnitude more than would be possible. Further, FSANZ's draft wording made clear that CBD-fortified products could not be used as a food ingredient.

The proposal follows two previous applications, submitted to FSANZ in 1998 and 2009, which also sought the legalisation of low THC hemp food products. These applications were both approved by FSANZ, but then rejected by the Forum due to concerns regarding law enforcement (such as road-side drug testing), CBD levels and mechanisms for marketing of low THC hemp food products. The approval of the Forum is a necessary prerequisite for the proposed changes to the Food Standards Code to become law.

Legalising hemp-based foods would bring Australia in line with Canada, the United States and the United Kingdom, amongst other countries that allow some hemp food products

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