

## Usage, benefits, and risks of agricultural receipts in Ukraine

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An agricultural receipt is one of the most effective tools of financing agricultural companies in Ukrainian agricultural business as a pledge of future crops. An agricultural receipt is legally a title document fixing an unconditional and secured obligation of a debtor to supply agricultural products or to pay money.

#### 1. Basic elements of transactions with agricultural receipts

The parties to a transaction involving agricultural receipts are the following:

- a creditor, i.e., the one, who provides the agricultural manufacturer with funds, supplies plant protection products (PPP), seeds, fertilizers, fuel, who performs works (e.g. cultivation), etc.;
- a debtor, i.e., the one, who receives goods and services from a creditor, undertakes to pay for them and pledges the future crops as collateral.

A person who owns or uses the land for growing agricultural products can be a

debtor.

Any legal or physical person can be a creditor.

An agricultural receipt is issued separately for each type of agricultural product.

An agricultural receipt is issued by a debtor and is kept by a creditor. It may only be issued in writing. In addition, such a document must be notarised and entered in the Register of Agricultural Receipts. An agricultural receipt is considered to be issued from the moment it has been entered into the Register of Agricultural Receipts.

Agricultural receipts may be of the following type:

- a goods receipt;
- a financial receipt.

If a goods agricultural receipt is issued to a creditor, a debtor undertakes to supply to a creditor in the future with agricultural products of the type, quality and quantity which are specified in the agricultural receipt. The agricultural receipt defines the terms of delivery, such as a place and date.

If a financial agricultural receipt is issued to a creditor, a debtor undertakes to pay the creditor a sum of money. The amount of the payment is determined under a formula agreed upon by the parties and refers to the prices of agricultural products in a certain quantity and quality.

Once a debtor has fulfilled its obligations (such as a delivery of agricultural products or payment of funds), a creditor returns the agricultural receipt to the debtor.

The fulfillment of the obligations under an agricultural receipt is secured by the debtor's future harvest. Information about the encumbered future crop is entered into the State Register of Encumbrances over Movable Property at the time of the agricultural receipt issuance. At present, agricultural receipts in Ukraine are primarily used in crop production.

## **2. Advantages of agricultural receipts for indebted agricultural companies**

### **2.1. Broader range of funding sources**

The traditional sources of financing, i.e., bank loans, are not always available to Ukrainian agricultural companies. Such happens for several reasons. First of all, it is the lack of property that a bank is willing to accept as collateral. Traditionally, Ukrainian banks have trust in real estate and machinery as collateral. But often the majority of a company's assets are either of low liquidity and poorly formed (e.g., equity property), expendable (PPP, fertilizers, seeds), or rapidly depreciating (agricultural machinery).

Ukrainian banks consider the most valuable asset of an agricultural company, i.e., its future production, as risky and hardly controlled collateral. Moreover, even if a

bank agrees to grant a loan against the pledge of future crops, it is still a complicated and long-term procedure. Agricultural receipts, on the other hand, allow getting resources from anyone relatively quickly.

## **2.2. Timely access to the resources required**

Medium and small agricultural businesses often fail to have both financial and logistical capacity to access effective PPPs and crop seeds etc. Agricultural receipts enable them to participate in supply programmes from large manufacturers precisely when it is technologically relevant.

## **2.3. Access to technologies**

Agricultural receipts allow Ukrainian agricultural companies to participate in the programmes that do not only relate to supplying the necessary resources but also provide cultivation technology.

## **3. Advantages of agricultural receipts for the Creditors**

### **3.1. Goods marketing development**

The companies producing PPPs, fertilizers and seeds are able to supply their products to a wider range of consumers who previously were unable to purchase such products.

### **3.2. Business expansion without extending the croplands**

Ukrainian agricultural companies with access to financial, logistical and technological resources can use agricultural receipts as a tool for growing products in cooperation with medium and small land users.

### **3.3. Risk mitigation**

Ukrainian legislation on agricultural receipts allows the creditor to use more efficient and rapid tools to obtain the funds it has invested, in particular:

- a creditor requires only an agricultural receipt for claiming against a debtor;
- the priority of a creditor over other debtor's creditors is confirmed by the registration of the pledge on the future crops in the State Register of Encumbrances over Movable Property;
- the legislation on agricultural receipts entitles a creditor to monitor the future crop (monitoring the debtor's compliance with cultivation technology, accessing to the cropland where the harvest is being grown and to the premises where the harvested crops are being stored);
- if the pledged crop is not sufficient, a creditor shall be entitled to enforce collection against other debtor's property;
- if an unscrupulous debtor has sold the pledged crop to another person, a creditor has the right to claim against such a person and satisfy the claims at the cost of his property;
- a creditor may transfer the rights under the agricultural receipt (such a deed shall be notarised) to the third parties;
- a creditor does not have to initiate proceedings in order to enforce the pledged crop; it is sufficient to do an enforcement inscription by a notary which is subject to immediate execution (within 7 days state/private enforcement

officers shall ensure that the pledged crop is handed over to the creditor).

#### **4. Risks of transactions with agricultural receipts**

The basic risks of transactions with agricultural receipts are the following:

- the creditor risk of not receiving the delivery (payment) under an agricultural receipt;
- the creditor risk of the loss of the profit as a result of a decreased price of products which is received under an agricultural receipt;
- the debtor risk of the loss of the profit as a result of an increased price of the products to be delivered under an agricultural receipt;
- the debtor risk of being an object to a raider attack by the creditor or persons to whom the creditor has transferred an agricultural receipt.

Factors of such risks can be both natural (e.g., weather conditions, insufficient watering) and subjective.

Subjective factors relate to the behavior of a creditor or a debtor. Due to the court practice, the debtor's main motivation for not fulfilling his obligations under an agricultural receipt lies in the temptation to gain more profit on selling the pledged crop. This temptation, of course, corresponds to the creditor's intention not only to get the payment for the resources delivered to the debtor but also to make money out of the difference of the delivery costs and gain on sale of the crops received under an agricultural receipt.

Under such circumstances, the debtor resorts to the use of gaps in the legislation on agricultural receipts and the flaws in the issue of an agricultural receipt.

Thus, Ukrainian legislation on enforcement proceedings does not establish sufficiently clear procedures for the foreclosure of the pledged crops. For example, a state/private enforcement officer can proceed with searching for such a property, and, failing to find it, he returns an agricultural receipt to the creditor without its execution.

Due to the specific nature of the pledged property, i.e., grain, it is not easy to find. The fact is that grain is a property of a generic nature and it is almost impossible to visually determine that the grain in the cornhouse has been collected from exactly those plots which are specified in the agricultural receipts. While a state/private enforcement officer is carrying out the necessary procedures in order to call for the records on the origin of the grain, an unscrupulous debtor may move or sell it.

If a debtor has moved the harvested crops to a cornhouse (an elevator), it is even more complicated for a creditor to get them. Ukraine has established the rules on handling and storage of grain, according to which grain is to be stored in the cornhouses by virtue of written agreements on grain storage. At the same time, an owner is provided with the relevant warehouse documents in the prescribed form which are subject to being recorded in a special register. A pledgee can legally get the grain only if it is pledged under a double warehouse certificate. In any other case, the cornhouse is entitled to release the grain to whoever provides the original warehouse document. Only the debtor is in possession of such a document, and he will not give it to the creditor under such circumstances.

An elevator may also legally refuse to release the grain to a state/private enforcement officer without having a court decision. This is due to the inconsistency in the procedure for compulsory enforcement of the agricultural receipts: the compulsory enforcement regulation refers to legal provisions that allow for the seizure of the collateral only from the debtor.

The debtor may also take advantage of the provisions of Ukrainian legislation stipulating the requirement for building consensus on the quality of the grain to be delivered under the agricultural receipt. To achieve that, he only needs to fail in building consensus in the grain quality issues, to appeal the appointment of an expert examination, or otherwise delay the collection process.

This and other similar inconsistencies in the legislation allow an unscrupulous debtor to successfully appeal against the procedures which are related to the compulsory enforcement of the products by a creditor under an agricultural receipt. In the meantime, the debtor can sell the grain at bargain prices.

In addition, a debtor may take advantage of drawbacks in the issue of an agricultural receipt. In particular, such deficiencies can be attributed to the specification of the use of the cropland by Ukrainian agricultural companies. As a result of land leases in small plots by hundreds of landlords, the crop acreage often resembles a chessboard. In the same field, various plots may be leased by different companies or individuals. Under such circumstances and for technological convenience, agricultural companies or farmers simply agree to mutually exchange the right to cultivate such plots without any paperwork. If the agricultural receipt has been issued based on a register of plots without notice of their location map, an unscrupulous debtor may use this in order to delay the collection process (e.g., not all the grain, which was harvested from the field, had been grown on the plots indicated in the agricultural receipt, and to delimit it, one must go to the court).

Often the creditor neglects the legal requirements for issuing and supporting agricultural receipts, i.e., he does not proceed with checking encumbrances, thorough monitoring the cultivation works and does not study the debtor's logistics, etc.

Force majeure is probably the most popular reason which is used by unscrupulous debtors in order to deprive a creditor of the ability to get deliveries under an agricultural receipt.

Since crop farming is indeed very dependent on natural circumstances, such a risk is a normal thing. It lays equally upon a debtor and a creditor. However, unscrupulous debtors via illegal means may fabricate the conclusions of the authorities on crop failure as a result of weather conditions. In that case, the creditor is forced to resort to judicial protection of the rights, while the debtor can sell the pledged grain at its own discretion in the meantime.

## **5. How to avoid risks in transactions with agricultural receipts**

It is impossible to avoid the risks arising from infidelity. However, a diligent approach to the preparation and support of the transactions with agricultural receipts can substantially complicate the actions of an unscrupulous party and it may become unprofitable for it to act illegally.

### 5.1. Legal due diligence of a debtor

The creditor should conduct due diligence of the debtor before commencing transactions involving the agricultural assets. Such an audit should include:

- an audit of the land assets (verifying the location of the leased land plots on the maps);
- an audit of the corporate matters in terms of powers to dispose of property, the conclusion of the agreements, etc.;
- an audit of the storage facilities used by the debtor;
- an audit of the liquid and valuable assets due to the debtor;
- an audit of the debtor's liabilities and encumbrances.

### 5.2. Monitoring rules

It is important to clearly and in detail define the monitoring rules and the creditor's rights and the debtor's obligations related to it. In particular, special attention should be paid to monitoring while harvesting and transferring pledged crops for storage, and proper warehouse documents (e.g. double storage certificates) should be issued.

### 5.3. Verified protocols of actions

The creditor should have verified action protocols in case of the debtor's unscrupulous acts. Such protocols are not a theoretical document. They shall be constantly supplemented with information while monitoring: where the debtor actually stores the crops, how he transports them, which grain elevators are used for storage, whether the land plots indicated in the agricultural receipt are cultivated by the due date, how the resources received from the creditor are used, etc.

### 5.4. Rules of the document flow

It is important to clearly adhere to the rules of document flow while accompanying agricultural receipts, i.e., to communicate through the channels agreed in the contract and collect a confirmation of such communications while making changes to the documents (e.g., contracts), duly amend all related documents, etc.