



**Asia-Pacific  
Economic Cooperation**

---

**2017/SOM1/EC/SEM/010**  
Session 8

## **International Instruments for MSMEs in Supply Chain Finance**

Submitted by: UNIDROIT



**Seminar on Use of International Instruments to  
Strengthen Contract Enforcement in Supply Chain  
Finance for Global Businesses Including Micro,  
Small, and Medium Enterprises**  
Nha Trang, Viet Nam  
24-25 February 2017



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

February 2017



Asia-Pacific  
Economic Cooperation

## Use of International Instruments to Strengthen Contract Enforcement in Supply Chain Finance for Global Businesses

### International Instruments for MSMEs in Supply Chain Finance

William Brydie-Watson  
Legal Officer, UNIDROIT



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Overview

- UNIDROIT's work in supporting international commercial relationships
- UNIDROIT instruments supporting supply chain finance
  - Convention on International Factoring
  - Legal Guide on Contract Farming



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## UNIDROIT

- Institute for the Unification of Private Law (UNIDROIT)
- Independent Intergovernmental Organisation set up in 1926 as an auxiliary organ of the League of Nations
- Re-established in 1940 on the basis of a multilateral treaty
- Membership in all continents (63 member States)
  - (10 APEC member States: Australia, Canada, Chile, China, Indonesia, Japan, Korea, Mexico, Russia and the United States)



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## UNIDROIT

- UNIDROIT Mission is to develop internationally harmonised, modern standards for commercial law.
- Statutory objective:**
- “to examine ways of harmonising and coordinating the private law of States, and to prepare gradually for the adoption by the various States of uniform rules of private law.”*
- Strong legislative role: 24 international instruments (treaties, principles, rules, model clauses) created.
  - Examples:
    - UNIDROIT Principles of International Commercial Contracts (1994, 2004, 2016)
    - Convention on International Interests in Mobile Equipment (2001)
    - UNIDROIT Model Law on Leasing (2008)
    - UNIDROIT Convention on Substantive Rules for Intermediated Securities (2009)



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Factoring Convention

- *The UNIDROIT Convention on International Factoring* (the “Factoring Convention”) was created to:
  - (1) Adopt uniform rules providing a legal framework to facilitate international factoring
  - (2) Maintain a fair balance of interests between the different parties involved in factoring transactions
- Preamble of the Convention:

*[State Parties to the Convention] CONSCIOUS of the fact that international factoring has a significant role to play in the development of international trade, RECOGNISING therefore the importance of adopting uniform rules to provide a legal framework that will facilitate international factoring, while maintaining a fair balance of interests between the different parties involved in factoring transactions,*



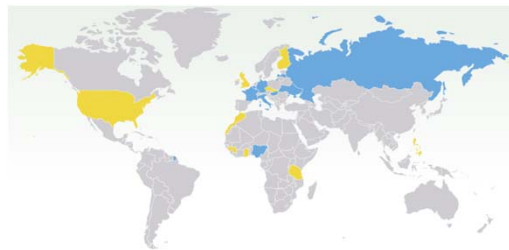
INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Factoring Convention

- Created in 1988 in Ottawa (the Ottawa Convention)
- **Entered into force 1 May 1995**

- 9 Contracting States:

- Belgium
- France
- Germany
- Hungary
- Italy
- Latvia
- Nigeria
- Russian Federation (2015)
- Ukraine



Signature ■ Entry into force ■

- Signed by Philippines



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Factoring Convention

- **Remember: Factoring** is a financial transaction and a type of debtor finance in which a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount.

- **Scope Article 1(2):**

For the purposes of this Convention, "factoring contract" means a contract concluded between one party (the supplier) and another party (the factor) pursuant to which:

(a) the supplier may or will assign to the factor receivables arising from contracts of sale of goods made between the supplier and its customers (debtors) other than those for the sale of goods bought primarily for their personal, family or household use;

(b) the factor is to perform at least two of the following functions:

- finance for the supplier, including loans and advance payments;
- maintenance of accounts (ledgering) relating to the receivables;
- collection of receivables;
- protection against default in payment by debtors;

(c) notice of the assignment of the receivables is to be given to debtors.



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Factoring Convention

### Application

The Factoring Convention applies:

- (a) Where supplier and debtor (customer) are in different states; and
  - (b) The Factoring Convention is in force in the States of client, debtor and factor; and
  - (c) Supply contract governed by law of a contracting state; and
  - (d) Factor provides at least two of these services:
    - Finance; or
    - Ledger accounting; or
    - collections; or
    - bad debt protection
- Notice of assignment given to debtor so limited to notification/notified factoring
  - Notice must be given by supplier



## Factoring Convention

Party Autonomy principle: Parties to a factoring contract may exclude application of the Factoring Convention (Article 3)

### Relationship with United Nations Convention on the Assignment of Receivables in International Trade (2001):

#### Article 38. Conflicts with other international agreements

1. *This Convention does not prevail over any international agreement that has already been or may be entered into and that specifically governs a transaction otherwise governed by this Convention.*
2. *Notwithstanding paragraph 1 of this article, this Convention prevails over the Unidroit Convention on International Factoring (“the Ottawa Convention”). To the extent that this Convention does not apply to the rights and obligations of a debtor, it does not preclude the application of the Ottawa Convention with respect to the rights and obligations of that debtor.*



#### Unidroit Convention on International Factoring

Topic	Provisions of Instrument
Assets covered	• Receivables arising from sale of goods [articles 1.1 and 2.1]
Transactions or issues covered	• Factoring contracts [article 2.1]
International transactions only?	• Yes. Supplier and debtor on underlying sales contract must be located in different states [article 2.1]
Principal exclusions and limitations	• Parties to factoring contract may exclude application [article 3.1(a)] • Parties to contract of sales of goods as to receivables arising from that contract, if notice given to factor [article 3.1(b)]
Possible overlap with other international instruments	• See United Nations Convention on Assignment of Receivables in International Trade which, by its terms, prevails over this Convention [article 38.2]
References to other international instruments	• None
PIL rules	• None
Key functional definitions	• “Factoring Contract” is contract where supplier assigns receivables arising from the sale of goods [article 1.2]
Effectiveness between parties	• No particular form required • May assign receivables in bulk [article 5(a)] • May assign future receivables [article 5(b)] • May assign receivables even if subject to anti-assignment term [article 6.1]
Effectiveness against third parties	• None
Priority	• None



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Factoring Convention

### Final Points

- Successful Convention currently in force in 9 countries, used as basis of modernising law in Lithuania and Russia
- Limited in scope to international notification factoring relationships
- Respects party autonomy principle: parties to a factoring contract may exclude application of the Factoring Convention (Article 3)
- Useful in improving the regulation of international factoring where more expansive reform is challenging

### Further resources

- Unidroit website: <http://www.unidroit.org/instruments/factoring>
- UNCITRAL, UNIDROIT, HCCH Texts on Security Interests: <http://www.unidroit.org/english/publications/joint/securityinterests-e.pdf>



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### What is Contract Farming?

- *“Agriculture production carried out according to an agreement between farmers and a buyer which places conditions on the production and/or marketing of the commodity.”*
- *“Contract farming is a form of supply chain governance adopted by firms to secure access to agricultural products, raw materials and supplies meeting desired quality, quantity, location and timing specifications, whereby the conditions of exchange are specifically set among transaction partners by some form of legally enforceable, binding agreement.”*



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Why is Contract Farming important?

- **Industrialisation of agriculture**, move away from fragmented production.
- Retreat of Government from subsidising agriculture, need for **private sector finance** to fill vacuum.
- **Contract farming is a credit mechanism** for agricultural producers.



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Benefits of Contract Farming

- Allows the contractor to **optimise operations** by securing a steady supply of quality products, following a precise processing method, without having to acquire land.
- Offers **greater certainty for the producer** in terms of marketing its products, cheaper and better quality inputs, access to credit, and opportunities in new markets, while **shifting part of the production risks to the contractor**.
- **Protects both parties** from market fluctuations by providing certainty and stability.
- Contract farming can also have **wider positive economic, social and environmental advantages**, not only for the parties but also for the community at large.





INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Risks of Contract Farming

- Contract farming may involve a number of risks, in particular deriving from the **power asymmetry between the parties** or **significant shifts in the market**.
- When the contractor arguably holds a **greater bargaining power**, it may draft clauses in its favour, with the potential for driving the producer to unsustainable levels of debt.
- Changing markets might prompt **unfair or fraudulent practices** by both parties, e.g. the producer selling the products intended for the contractor to a third party, because the market price is higher than the contract price (side-selling).
- **Enforcement of the contract** may be problematic in certain jurisdictions due to inadequate judicial proceedings.



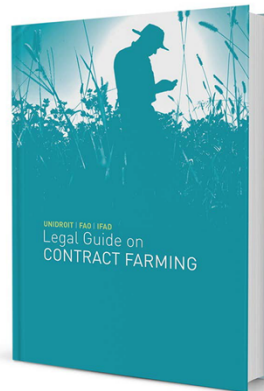
INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Development of the Legal Guide

Joint project between:

- the International Institute for the Unification of Private Law (UNIDROIT),
- the Food and Agriculture Organization of the United Nations (FAO) and
- the International Fund for Agricultural Development (IFAD).



Food and Agriculture  
Organization of the  
United Nations



Investing in rural people



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Development of the Legal Guide

- Consultations with stakeholders in Addis Ababa, **Bangkok**, Buenos Aires and Rome
- Primarily addressed to parties to a contract farming relationship, however also provides practical guidance to governments, international organisations and legal practitioners.
- Guide promotes stable and balanced relationships in order to assist parties in designing and implementing sound contracts and developing good practices.



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Matters covered by the Guide

- Parties, formation and form
- Obligations of the parties
  - Risk allocation, product quantity and quality, production, delivery, price and payment
- Excuses for non-performance
  - *Force majeure*, change of circumstances
- Remedies for breach
- Duration, renewal and termination
- Dispute resolution
  - Mediation, arbitration, judicial dispute resolution, access to justice and enforcement



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Implementation of the Legal Guide

- Utilised as a guidance instrument **for policymakers**

*“the Philippine Government utilizes the Legal Guide in framing the issues and setting the benchmarks on contract growing arrangements entered into by smallholder farmers, including those that are family farmers. .... the Legal Guide [...] informed the regulations being crafted on agribusiness investments with smallholder farmers who are property rights owners of lands emanating from the agrarian reform program”*

Mr Lupino Lazaro, Jr. (Agricultural Attaché, Embassy of the Philippines in Italy) - UNIDROIT Conference 27 April 2016



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Implementation of the Legal Guide

- Coordinated inter-organizational approach
- Development of implementation materials:
  - Guidelines on Contract Farming operations (English, Spanish, French)
  - Policy briefs for farmers and regulators (10 pages, three languages)
  - Contract templates for agricultural commodities
  - Analysis of legal and regulatory frameworks
  - Training programme (workshops in Viet Nam in 2016, Asia-Pacific in 2017)



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## Legal Guide on Contract Farming

### Resources

- Legal Guide released July 2015, available freely online (English and French)
  - <http://www.unidroit.org/work-in-progress-studies/studies/contract-farming>
- Community of practice on legal aspects of Contract Farming
  - <http://www.unidroit.org/community-of-practice/home>
- FAO Contract Farming Resource Centre
  - <http://fao.org/ag/agcs/contract-farming/index-cf/en/> (currently being updated)



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE



**Thank you for your attention!**

**[w.brydie-watson@unidroit.org](mailto:w.brydie-watson@unidroit.org)**