



# The pre-emption right in Italian agriculture: A preliminary evaluation of the direct farmer-neighbouring owner's case



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## ABSTRACT

Direct farmer-neighbouring owner's pre-emption right has played an important role in the Italian farmland market since 1971. This right gives preference to a direct farmer owner in purchasing a land lot neighbouring his property among other buyers. After dealing with the main characteristics of the right regarding both the farmland market and its economic content in the frame of the farm evaluation theory, the paper presents a first evaluation of this right, by means of the Contingent Evaluation method. Willingness to accept (WTA) for not exerting the right was estimated from 119 farmers' samples and a set of farm- and farmer-related variables was employed to explain WTA. Average WTA accounts for about one-sixth of the land value, but variability is quite high. The factors with the highest impact on the right value are the presence of a child willing to carry on the farm business, the land value, and the share of irrigated land. Low values appear related more with the direct farmer's status than a real intention to enlarge the property.

## 1. Introduction

The pre-emption right (PR) can be described as the right by which a beneficiary has an entitlement but not an obligation to buy a specific real asset at a definite price, or it can be regarded as having priority over others in claiming the title to a real asset that is subject to pre-emption. More specifically, when the property is on sale, a PR confers the beneficiary the privilege to buy it on the same terms as those accepted by a third-party buyer. Therefore, its purpose is to secure the priority of acquisition of a defined item to a person before other potential purchasers.

The PR right is a typical latent right. Only when the present owner decides to sell the property does the right take effect. The right holder as such has no means of forcing the present owner to sell. It can be interpreted as a sort of call option on an asset, with no strike price and no expiry date. Walker (1999) defines it as a 'contingent option', as far as the effective use is contingent on the owner's decision to sell the asset rather than on the holder's willingness to buy it.

The dynamic for exercising a PR is usually as follows. First, the present owner as seller and an interested buyer go through the normal negotiating process. The buyer investigates the property and items related to it, and he and the seller negotiate a price. When they have finalised their contract, but before the transfer of the property is completed, the beneficiary receives a copy of the contract and has the right to step in. Based on his interest in the property and the contents of the contract, the beneficiary decides whether he wants to take over the

contract as it stands, including the agreed-upon price and any special stipulations. The beneficiary then becomes the owner of the property, and the buyer is left with nothing (Zevenbergen et al., 2008, p. 263).

PRs are widely employed in many contract settings, which are freely agreed to by the parties or are imposed by specific legislations. In the first case, areas of application are management agreements, franchise agreements, joint ventures, agreements among shareholders of a closely held company and overall real estate sale and lease contracts (Kahan, 1999). In the second case, the PR is mainly restricted to real estate sales and lease contracts relating to both urban and rural assets.

The PR beneficiaries can belong to different categories. Essentially, any type of natural or juridical person can be a beneficiary, although possible beneficiaries vary according to the nature of the PR. For legal PRs, they could be local (e.g., municipalities) or national authorities. Nevertheless, they can be specific groups of private individuals as well (like neighbouring or tenant farmers, apartment users or co-owners of an asset).

Limiting our attention to the use of PR in agriculture, the use appears quite widespread. We remember the Crown's PR on the sale of land belonging to the indigenous people of New Zealand and Canada (Gocke, 2013). Today, authorities can exert the right in countries having different development levels. In France, the SAFERs (Sociétés d'aménagement foncier et d'établissement rural) own a PR on all the agricultural land put on sale to avoid transfer of land that may obstruct structural improvement; after making the necessary enhancements, the land is resold to farmers (Boinon, 2003; Merlet and Levesque, 2008;

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Van Holst, 2011). The basic aim of this right consists in favouring medium size family farms, which can prove to be economically viable, by supplying them the needed land; at the same time, farmland consolidation into large units may be of benefit to the local economy.<sup>1</sup> Similar public right is found in Norway (Bray et al., 1979) and Namibia (Adams and Howell, 2001). In Uzbekistan and in the Russian Federation, a PR is granted to local governments on sale of private land (Eckert and Elwert, 2000; Wegren, 2009). The governments of the Netherlands and Germany own a PR that is limited to the sale of farmland suitable for development projects (Van der Molen, 2013).

PRs granted to a single farmer as personal rights are frequent in many country's agrarian laws. In fact, tenants hold a PR on the leased land on sale in Belgium, France, Hungary, Italy, Latvia, Lithuania, the Netherlands, Portugal, Romania, Slovenia and Sweden. On the other hand, farmer-owners have a PR on neighbouring land on sale in France, Hungary, Italy, Latvia, Macedonia, Portugal and Slovenia (Giovarelli and Bledsoe, 2001; Prosterman and Rolfes, 1999; Zevenbergen et al., 2008; Swinnen et al., 2014). In France, the recent Modernisation Law of Agriculture (2010) created a PR right in favour of the neighbouring owners, even for forest stands on sale (Deuffic et al., 2015). The genesis of the PRs within a legislation varies in relation to the emerging of particular policy issues in a country. PR assigned to local administrations in some north European countries arose in order to prevent speculation in the change in land use following the urbanization process; Farmers' PR in many Eastern European countries were intended to avoid unfair distribution of land in its privatization following the fall of the Communist regimes. However, sometimes a restructuring has happened, as in the case of Croatia, where a PR was created in favour of family farm owners in 2008, but it was declared unconstitutional after a few years on the grounds that it excessively undermined the property right (Svržnjak and Franić, 2014).

More subjects than those previously mentioned can hold a PR on farmland. An example of extensive use of PR for agricultural and forestry land put on sale is that allowed by the Slovenian legislation. The PR may be claimed by beneficiaries in the following order: 1) the co-owner, 2) the farmer owner whose land is adjacent to the land to be sold, 3) the tenant on the land to be sold, 4) another farmer, 5) agricultural organisation or a self-employed person that requires land or a farm holding to perform their agricultural and/or forestry activities and 6) the National Farm Land and Forest Fund of the Republic of Slovenia (Zevenbergen et al., 2008). A similar ranking can be found in Hungary and in Poland for alienation of agricultural land (Téglási, 2014; Dadańska, 2015). Right holders' priorities in exercising the right are established according to the hierarchy of goals embedded in the agricultural policy of a country. For example, in Italy the farmer's access to land property has been considered more important than the size increase, leading to favour the tenant's PR in spite of the neighbouring farmer's. Priorities do not necessarily reflect the general advantage of agriculture, rather they are mostly the outcome of conflicting interests at a certain stage of the political process, which become often crystallised along the time.

Although PRs appear to be well investigated from a juridical viewpoint (e.g. Houser, 1987; Daskal, 1994; Mitchell, 2001) and despite their wide diffusion, economic literature has paid only limited and recent attention to them. The debate has focused mainly on the value of the right of first refusal (RFR) rather than the right of first offer<sup>2</sup> (RFO), on its profitability *ex ante* or *ex post* and on its efficiency compared

with either its absence or the inclusion of other contracting clauses.

Results of these analyses do not agree on PR pros and cons and do not show a clear motivation for the existence of this right in a private contract. On one hand, some studies recognise the cost of a RFR for the contracting parties (Walker, 1999), the advantages for the right holder at the expenses of the sellers and the other buyers; Bikhchandani et al. (2005) and its sub-optimality compared with an auction sale (Arozamena and Weinschelbaum, 2006). On the other hand, the wide inclusion of this right in many private contracts have led researchers to deepen the economic motivations behind its adoption (Walker, 1999). In this regard, Kahan (1999) stresses the role of a PR in dealing with imperfect information and indicates some circumstances in which it may enhance efficiency. Choi (2009), by comparing a RFR to an English auction, concludes that the former increases the joint profit of the seller and the right holder by reducing the third party's profit. Moreover, a special contractual design of the PR may even be disadvantageous to the right holder (Grosskopf and Roth, 2009). A recent work by Kahan et al. (2007) appears particularly interesting. By considering a sequential bargaining framework, they define the conditions that yield benefits to or impose costs on the right holder and the seller for both the RFR and the RFO cases. They show that no arrangement (i.e., no right, RFR and RFO) is superior to another, given that the PR's ability to determine a surplus depends on buyers' valuation distribution, buyers' investigation costs, buyers' number and the cost of delaying purchase.

Only two PRs granted by law are discussed in the above-mentioned works: a PR granted by the British law on the apartment sale to the user (Grosskopf and Roth, 2009), and a PR given by the Iowa and Minnesota legislations to the mortgagor on land put on sale by banks (Walker, 1999). Both the authors share the view that PRs are acceptable only if the social benefits they achieve prevail over the private disadvantages, as it happens for other ownership rights limitations, which are omnipresent in the legislations and have economic justification (Miceli and Sirmans, 2005).

Previous literature on PR appears to be quite inconclusive on its usefulness both in private contracts and in general legislation. Although much legislation has given farmers specific PRs, we could find very few papers dealing with this issue from an economic viewpoint. One deals with the effects on the farmland market due to the PR granted by Italian legislation to neighbouring farm owners (Antinelli et al., 1995). Another presents an interesting model for valuing a RFR owned by the government in the context of a farmland preservation policy in the United States (Malcolm et al., 2005). Other works present comparative overviews of PR applications or deal with it within land policy issues (Zevenbergen et al., 2008; Van Holst, 2011; Levesque, 2016), but without expressing a clear opinion on the PR as a political tool. At present, no economic evaluation study on this right seems to be available.

Partially filling this gap is the goal of our research, which aims at being the first attempt to evaluate the most pervasive PR in the Italian agriculture: the direct farmer-neighbouring owner's pre-emption right (DFNOPR). Its efficacy has been strongly debated since the time (1971) it was introduced in the Italian agrarian legislation. This PR has been criticised for limiting the seller's freedom to negotiate the agreement with whom he prefers. Others defend it on the basis that it improves the family farm structure according with the goal stated in the Italian Constitutional Law (art. 47), which favours the development of the family farm ownership, without putting any cost on public budget.

More specifically, our purpose is twofold: a) a preliminary estimate of this right and b) the investigation of factors that most influence its value. The first section of the paper describes the key features of this right according to the Italian legislation and offers an economic interpretation of it according to the farm evaluation theory. The second section relates to the evaluation method and dataset. In the third section, we deal with the results of the analysis and discuss them. Final comments conclude the paper.

<sup>1</sup> The SAFERs have PR on most rural property. SAFER can pre-empt at the sales price and on the other terms stated in the sales contract. However, if they disagree with the price, they can resort to legal action.

<sup>2</sup> This is another kind of preemption right, which is less commonly used than the RFR. It implies that the grantee be submitted an offer to buy an asset before it is offered to other potential buyers. In the RFR case, the grantee is submitted an offer to buy an asset after a sale contract has been defined with another buyer. He can refuse or accept to buy it in accordance with the contract conditions.

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