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Legal Guide on Contract Farming

Abstract Document

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Presentation

This abstract summarizes the forthcoming UNIDROIT/FAO Legal Guide on Contract Farming.

The Guide is being prepared by the International Institute for the Unification of Private Law (UNIDROIT), together with the Food and Agriculture Organization (FAO), and with the support of the International Fund for Agricultural Development (IFAD).

The full Guide is due for publication in 2015 after the conclusion of a multiyear collaborative drafting process that is designed to incorporate a global range of viewpoints. The Working Group for the preparation of the guide brings together internationally-recognized legal scholars, partner multilateral organisations and representatives of the farmer community and agribusiness interests. It is the objective of the Guide to address the range of legal issues that may arise in contract farming and provide soft guidance and an internationally-recognised reference with a fair and balanced approach.

The World Farmers Organisation (WFO) has participated as a key partner representing the professional and trade interests of farmers and has also provided support through the sharing of expert knowledge and the participation of delegations of experts providing comments and inputs on the drafts.

More information about the Guide and its preparation may be found on the UNIDROIT website at www.unidroit.org. More information about contract farming (in general) may be found on the website of the FAO Contract Farming Resource Centre at <http://www.fao.org/ag/ags/contract-farming/index-cf/en/>.

This abstract document provides an overview of the content of the future Guide, and is based on the working documents which have been prepared for the 3rd session of the Working Group (3-7 March 2014). It is in particular intended to be used as a basis for discussion at the consultation events to be held with stakeholders in the first half of 2014. Its structure follows the various chapters of the Guide. However, because of its very nature, it does not reflect the level of detail or complexity in the legal approach that the final version of the Guide will have.

Comments addressing specific questions addressed in this document are welcome, as indeed are any other general or particular issue that may be relevant for the drafters, regarding domestic legislation and contract practice of contract farming operations. Comments may be sent to UNIDROIT at info@unidroit.org (specifying as the subject: "comments on contract farming"). UNIDROIT would in particular welcome receiving sample contracts or contract clauses, where the names of parties and other identifiable elements can be cancelled. UNIDROIT guarantees that confidentiality will be preserved in using the information.

This abstract document will be revised over the coming months to reflect changes in the drafting of the Guide and feedback during the consultation events.

Introduction

The **Legal Guide on Contract Farming** is primarily addressed to the parties to a contract farming relationship, i.e. producers and contractors. It provides advice and guidance on the entire relationship, from negotiation to conclusion, from performance through breach or termination of the contract. The Guide provides a description of common contract terms and a discussion of legal issues and critical problems that may arise under a variety of practical situations. It illustrates how these may be treated or are regulated under different legal systems, including when relevant, specific legislation on contract farming. In so doing, the Guide aims to promote a better understanding of the legal implications of contract terms and practices.

Agricultural production under a contract between farmers and their buyers has long been practiced for many agricultural commodities in most countries around the world. Under contracts entered into with agricultural producers, food processors, traders, distributors and other purchasers of agricultural products organise their procurement systems in accordance with their specific needs with regard to quantity, quality, timing of delivery and other supply chain management requirements. Contracts may also specify the desired requirements for agricultural production or livestock rearing processes, often following domestic and international quality and safety standards for food and agricultural production and trade.

Under a broad economic approach, “contract farming” generally refers to “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. The specifications can be more or less detailed, covering provisions regarding production technology, price discovery, risk sharing and other product and transaction attributes.”¹

As it is understood in this Guide, contract farming refers to a particular modality of agricultural production based on an agreement between a farmer and another party – typically an agribusiness company. Under the parties’ agreement, which is designated as an “agricultural production contract,” the farmer would undertake to produce and deliver agricultural commodities in accordance with contractor’s specifications, while the contractor would undertake to acquire the product for a price and would provide a certain degree of control over the production through a variety of forms. For example, the contractor could provide inputs, services, technology, financial support, and/or a close monitoring of the production process, including through certification.

The intensity of the control exerted by the contractor may determine different levels of integration of the supply chain, ranging from a collaborative form to highly integrated relationships. When integrated relations are involved, the intensity and form of the control exerted by the contractor should not be such as to modify the legal nature of the relationship, for example into a partnership or an employment relationship.

Contract farming has several potential benefits and associated risks. It is generally recognised for its potential to sustain and develop the production sector by contributing to capital formation, technology transfer, increased agricultural production and yields, economic and social development and environmental sustainability. Final consumers as well as all participants in the supply chain may also draw substantial benefits from varied and stable sources of supply and efficient processing and marketing systems. Governments are increasingly mindful of the role that contract farming can play in agricultural development, and some governments have instituted enabling policies to attract private sector investors and to coordinate ventures with local producers, sometimes under public private partnerships. On the other hand, contract farming may involve a number of

¹ Da Silva, C. in: *The growing role of contract farming in agri-food Systems development: drivers, theory and practice*, Agricultural Management, Marketing and Finance Service FAO, Rome, 2005.

risks which, excluding risks facing all other forms of agricultural production, for a large part derive from the typical imbalance in the bargaining power of the parties.

PRIVATE LAW REGIME APPLICABLE TO AGRICULTURAL PRODUCTION CONTRACTS

Understanding how a particular agricultural production contract is regulated will help parties give due consideration to mandatory provisions and to default rules which will or may be applicable, and thus draft better terms. It will also be useful for parties involved in dispute resolution mechanisms, especially regarding interpretation issues and the identification of default rules which may be available, and this would appear particularly relevant for third party mediators who play a major role in assisting parties to sort out disagreements throughout the life of the contract.

Determining what legal regime applies to a particular contractual relation involves characterising the relation as possibly falling under one legally defined contract type under the applicable law. Special contracts are regulated by particular sets of rules which in certain cases are mandatory, or would provide solutions for matters which have not been otherwise regulated by the parties (by so-called “default rules”). This will apply for example to the time when title transfer operates, to the scope of the obligations of the parties, to price determination, or to time limits.

For contracts involving complex relationships with more than one characteristic performance, different approaches may be used to characterise the transaction. In certain instances, the law itself may create a regime applicable to that particular transaction, which thus becomes “typified.” When no such special regime exists, different approaches may apply. Under one possible approach, the contract would be seen as “*sui generis*” on account of its totally original character, and rather than being directly applicable, rules concerning similar contracts may be applied by analogy. When found to be *sui generis*, the content and equilibrium of the contract will essentially rely on the freedom of the parties. However, the autonomy of the parties may encounter a number of limitations through public policy rules which will apply mandatorily. In addition, the applicable law would provide default rules when the parties have not agreed on essential terms of the contract. Domestic legal sources would include statutory provisions, general principles, traditional and customary rules, usages and practices, and soft law. In certain circumstances international sources may be relevant.

Increasingly, national economic and social policies recognise the special nature of the agreements between agricultural producers and market operators under the perspective of offering enabling conditions to investors in the processing industry, enhancing the participation of farmers in commercial production and their access to markets, while promoting equitable dealings between the parties. In a number of countries, relationships between the operators involved in primary agricultural production and the market have not only been identified and nominated, they have been regulated through substantive rules - generally combining mandatory rules and default rules -, thus creating one or several specific types of contract.

REGULATORY ENVIRONMENT

In addition to the legislation governing the obligations and responsibilities of parties and the elements of a contract farming operation and the formation and implementation of the contract, parties will be subject to a number of laws and regulations that will influence other elements of the contract, particularly the access to agricultural inputs (including labour in agriculture) and the technical specifications for agricultural production. In most cases, these legal instruments will be aimed at the development of the agricultural sector and the safeguard of rural populations. These involve the regulatory protection of human rights in agriculture, food safety and the protection of animal and plant health and the environment; decent rural employment in agriculture; laws governing the access to natural resources necessary for agricultural production contracts; and the access to agricultural inputs and the trade of agricultural products.

Parties to the Contract

There is a range of parties which may be involved in an agricultural production contract. Often, one single producer will be engaged toward one contractor under a bilateral relationship reflected in the agricultural production contract. However, other entities may also participate in the arrangement, characterising a multiparty contract. In other situations, such third-party entities could deal with one of the parties on the basis of a separate but linked contract which is instrumental for the performance of the central agricultural production contract.

AGRICULTURAL PRODUCERS

An agricultural producer may be defined in various ways, and even within a particular country different criteria may apply depending on the context or purposes of particular laws and regulations in the many areas which may concern the agricultural sector or activity. Two criteria in particular are generally relevant to the task of characterising an agricultural producer: the nature of the produced goods, and the nature of the activity itself.

Depending on the country, the concept of “agriculture” may relate to the exploitation of land, forest, marine and freshwater as original natural resources. Very often it refers to obtaining primary products from identified sectors, typically crop cultivation, animal husbandry, forestry and aquaculture, as well as products directly derived from such activities such as the production of milk, honey, and silk. In many countries, an analytical approach focuses rather on the control of a “biological cycle,” a concept which refers to one or several operations carried out with a view to the biological development of vegetal and animal products. Another criterion assumes that the producer, whatever its size and structure, carries out the production of agricultural products on an independent and professional basis.

Producers may exploit a single production unit, as natural persons or formed under partnerships or corporate structures. In most countries, specific legal forms may be available for agricultural producers. On the other hand, under producer organisations, producers would produce together or pool their individual production to be marketed collectively. Depending on the legal form and the particular legal system, in contract farming operations, producer organisations such as self-help groups, associations or cooperatives would either act in their own name or act as an agent regarding members’ obligations toward the contractor. In many countries, relationships between the cooperative and its members would be regulated by a special legal regime,

Each particular form or structure for the producer entails a range of different rights and obligations, and may have a decisive influence on the management and the potential development of the activity from a business perspective.

THE CONTRACTOR

The contractor is the party commissioning the production from the producer and providing a certain degree of control for the production. Typically, the contractor will be an entity that manufactures or processes the produce. The contractor may either sell it to the final consumer, as it occurs increasingly with supermarket brands, or to other chain participants for further processing and onward sale along the supply chain. The contractor could also be a wholesaler or an exporter. Besides commercial entities, other types of contractors may be involved such as cooperatives, and in particular occasions, also a public entity.

Contractors may vary widely in size, business formats, and ownership. For example, companies may be small businesses dealing with limited numbers of farmers and supplying buyers in the local market. But, contractors could also be entities conducting large scale operations for domestic or export markets. As food supply chains

are highly concentrated and operate globally, the contractor would frequently be part of a corporation or a group with an international reach, generally operating locally through a subsidiary, incorporated as a legally independent entity.

OTHER RELEVANT PARTIES

Various other parties may be involved in the agricultural production contract or be affected by the production relationship. Such parties may be broadly described as value chain participants, third party creditors and public (government) entities.

Value chain participants include parties adding value to the final product along the supply chain, from its conception through production, transformation, handling of the product up until final consumption. Various actors may be related to the parties to the production contract and linked together through institutional or contractual relations. Participants would thus include final consumers, input suppliers, providers of services (for example technology), finance, insurance, parties involved in verification and compliance mechanisms including certification entities, and extension service providers.

Additionally, different categories of creditors may claim interests which could affect the rights of the parties under a production contract. Such claims could in particular refer to the contracted land. This situation may arise when the producer has uncertain land tenure rights and its entitlement to exploit the land is challenged, jeopardising its ability to perform the contract over the agreed duration. Also, based on the contract or the law, the landowner may have a claim on the land or on the crop itself such as a lien over the crop for unpaid rent. Other creditors, typically banking institutions, may claim rights over the land or the crop when the producer has granted a pledge, and has not complied with its repayment obligations.

Lastly, although the agricultural sector relies principally on market actors and private initiative, public interventions remain generally important. Relevant public policies address access to food and food security concerns, health and food security objectives, as well as social and labour and environmental protection. Public policies may also seek to develop enabling conditions to support participants in agricultural production and marketing, encourage adequate coordination between production capacities and market requirements, and correct market failures or distortions.

Contract Form and Formation

CONTRACT FORM

As a general rule, contracts are not subject to any requirement as to form. In most cases, these contracts will take the form of a written agreement. In scenarios in which one party has limited literacy, an oral explanation may accompany a written agreement. On occasion, due to industry custom, local practices, the desires of the parties or other circumstances, the contract will be an oral or “handshake” agreement, with no accompanying documentation.

National or other laws of the jurisdiction, however, may override this principle. As a matter of good contracting practice, written contracts are encouraged as a means to improve the clarity, completeness, enforceability and effectiveness of the parties’ agreement. Care should be taken to ensure that parties to the contract that may possess limited literacy skills fully understand the terms. In these circumstances, a neutral third party may read the written contract aloud. Similarly, in instances in which the parties conclude a verbal agreement, it should take place in the presence of a third party without an economic interest in the producer-contractor relationship.

Very often an offer to enter into an agricultural production contract is made to multiple producers on standard forms, using standard terms, and incorporating by reference standards contained in other documents. The producer's legal freedom to enter into any contract may be overshadowed by the lack of freedom to negotiate specific terms or reject a lawful, yet economically unbalanced contract. Non-negotiable contracts of adhesion typically protect the interests of their drafters, and risk minimizing the realization of the reasonable expectations of the other party. Thus, in case of ambiguity many legal systems apply an interpretation which operates against the contract drafter. In instances of gross disparity in the literal terms of the contract, the affected party may avoid the contract or seek redress by a court to modify the contract to conform to reasonable commercial standards of fair dealing.

In light of the potential for disparity of economic power between the parties, unequal information, and anti-competitive practices, some jurisdictions have enacted specific regulations regarding the required form of agricultural production contracts. Specific requirements range from readability standards to substantive terms of the agreement, such as limitations on confidentiality clauses and clear disclosure of production standards. In these jurisdictions, failure to follow requirements to form or substance may result in avoidance, reformation of terms, or administrative actions such as cancellation of the contractor's license.

Although agricultural production contracts may take many forms in order to account for the diversity of products, legal jurisdictions and contractual practices, key components present in most written arrangements include: specification of the parties; description of the area under production; purpose of the contract; duration and renewal provisions; obligations of the parties; terms of payment and delivery; dispute resolution provisions; termination; and a signature clause.

CONTRACT FORMATION

An agreement is the bargain reached by the parties, while a contract consists of the parties' legal obligations that result from the agreement. The concepts of offer and acceptance traditionally have been used to determine whether the parties reach an agreement, with a contract concluded either by the acceptance of an offer or conduct of the parties sufficient to demonstrate the agreement.

Because the mere acceptance of the offer concludes formation of the contract, the offer must be sufficiently descriptive and definite to encompass the terms of the agreement. Courts will not enforce contracts in which the intentions of the parties are incapable of determination. Vagueness, indefiniteness and uncertainty with respect to any of the essential terms of the agreement may render it unenforceable. As a general rule, the material terms of the parties, subject matter, price, payment terms, quantity, quality, and duration must be sufficiently definite such that the respective promises and performance obligations of each party is reasonably certain. Most often, in jurisdictions with special rules for agricultural production contracts, these descriptive terms must be included fully within the written document proffered to the producer for signature.

Preliminary negotiations refer to the bargaining communications of the parties prior to the acceptance of an offer. Whether a preliminary communication is an operative offer capable of acceptance or merely a step in preliminary negotiations is an issue of careful consideration. Mere statements of intentions, estimates, advertisements, price quotations and "agreements to agree" may appear to the lay person as definitive offers or binding contracts, but lack legal enforceability due to indefiniteness with respect to the finality of terms comprising the bargain and an intention of the parties to be bound by the agreement.

The enforcement of contract terms requires legal capacity at the point of contract formation. Contracts induced by fraud, mistake or duress may also be voidable by the aggrieved party. With respect to mistake, the erroneous belief must relate to the facts at the time of contract formation, not a party's prediction or judgment about the future. Moreover, the effect of the mistake must be such that enforcement would give rise to unconscionability or the other party was at fault for the mistake. Similarly, a knowing misrepresentation by one party may rise to the level of fraud if it is intended to induce assent from the other party.

Improper pressure during the bargaining process in the form of duress or undue influence may result in a voidable contract. In some instances, economic duress or business compulsion may qualify as an improper threat. Wrongful acts taken in order to secure a private benefit may include threats to put one out of business or deprive one of their livelihood, or threats to institute criminal or regulatory actions.

Parties' obligations

OVERVIEW

In agricultural production contracts, producer's and contractor's obligations and responsibilities are typically interlinked – in a more or less intense manner (from light intervention to full integration), with the result that one party's performance will very often be dependent upon the other party's compliance. The producer mainly undertakes to produce the goods in accordance with contract specifications and requirements, and to deliver the goods to the contractor in accordance with contract specifications and requirements; but, such commitments may be conditioned upon the contractor's prior performance, such as the provision of inputs or technical services. A number of other subsidiary obligations are related to these main duties, such as to pay for the inputs and to reimburse different forms of financing it may have received from the contractor. Conversely, the central obligation of the contractor under an agricultural production contract is to purchase the product or, depending on the nature of the arrangement, remunerate the producer for the services rendered in producing the commodity. Furthermore, it is a common feature of many agricultural production contracts that contractors agree to – or may even insist on – supplying various inputs for the production process. Lastly, agricultural production contracts often empower the contractor to exercise a more or less close oversight of the production process, including by supplying instructions and know-how to the producer.

CORE OBLIGATIONS

The producer's central and primary obligation is to produce the goods in accordance with contract specifications and requirements, particularly in terms of quantity and quality. Therefore, within the core obligations of production and delivery, aspects related to quality and quantity are crucial. Regarding **quantity**, in a very common situation, the whole crop of one or several years is purchased by the contractor, often with references to the surface area to be cultivated. However there are also contracts which provide for the purchase of only a percentage of the future crop, a specified quantity, a minimum quantity, a quota, or a variable quantity depending on orders. Some contracts state that the quantity will be determined later, on the basis of field tests conducted during the growth of the crop. Similar arrangements can be found in agricultural production contracts dealing with animal husbandry.

The concept of **quality** implies fitness for the intended purposes, chiefly the safety of the product and compliance with contract requirements. For many commodities, quality standards and properties are subject to public regulations. The producer undertakes obligations regarding the quality of the produce. Delivering conforming goods of the required quality may be a strict obligation or not depending on the particular situation (in particular the nature of the defect) and/or the particular contract type (i.e. constituting breach and entitling the contractor to reject/terminate or to exercise other remedies). It is important to appreciate that delivery alone does not constitute acceptance of the goods, and the contractor is usually provided the right to examine the goods before acceptance, and often the contractor is obligated to examine them before acceptance. The examination may occur before or after the delivery of the goods.

Paying the price is the central and essential legal obligation of the contractor. The price is a transfer of money by the contractor for the value payable in return for the goods or services delivered by the producer. When the contractor has delivered inputs on credit terms or has made money advances, the price of the inputs and

advances together with corresponding interests (as applicable under the contract) will be deducted from the price. It is necessary in an agricultural production contract, as with any contract for the sale of goods or contract for services, that the parties agree to the price for the goods or services. The degree to which a price term has to be definite at the time of contract formation, or is subject to final determination at a later time, varies among legal systems. Since the price is most often set by the contractor with little or no opportunity for the producer to negotiate the amounts and the basis of calculation due to imbalances of bargaining power, it is all the more important that the contract provides transparent information on price before the production begins, and even before the contract is concluded.

ADDITIONAL OBLIGATIONS DURING THE PRODUCTION PROCESS, DELIVERY, AND PAYMENT

Beyond the core obligations of any agricultural production contract, the parties will typically have a number of related obligations which may become important at various points during the agricultural production cycle. A few of the most common obligations are highlighted below.

Production Process

Inputs encompass all physical and intangible elements that are used in the production of the final agricultural product. Whereas some inputs, such as land for example, may be provided by the producer, when the producer is to use contractor's inputs, it may have to comply with a number of contractual obligations. The first category of obligations here relates to receiving the inputs; this obligation goes along with corresponding obligations to check for conformity of the inputs (keeping samples, keeping records), and to notify of apparent defects. The second category of obligations relates to taking care of the inputs. Depending on contract specifications, this could involve a far-reaching obligation upon the producer, especially as regards the risks for the loss (for example loss of the animals provided). When the risks of the loss of the goods bear upon the producer, it may be required to take out insurance. Lastly, the third category of obligations relates to using the inputs according to the indications given by the contractor. This category has certain subsidiary obligations such as to observe the necessary precaution in use; to keep records and comply with administrative obligations; to use the inputs exclusively for the purposes of the contract, involving giving back unused inputs – and not diverting the inputs by selling them or using them for personal purposes. Conversely, the use of inputs from other sources is normally forbidden in such cases where inputs are provided by the contractor.

In carrying out the agricultural production, the producer will be bound to apply good practices. Most agricultural production contracts oblige the producer to follow the **methods** prescribed by the contractor. Depending on the agreement of the parties, the scope of the decision power of the parties would vary: the producer may be bound to comply with the contractor's instructions (and may be required to ask for instructions and obtain authorizations); or decisions may be taken together; or the contractor will directly provide certain services. In particular, typically the contractor will provide technical assistance. Depending on the particular provision and circumstances, the producer will either be required to reach a particular result and will therefore be bound by a strict obligation or the producer will be required to employ apply skills, diligence and best efforts – in this context, the producer may be under a duty to monitor its performance on an ongoing basis. This distinction has important consequences regarding the remedies that the contractor may employ in the event of non-performance by the producer.

One important obligation of the producer during production is generally to cooperate with the contractor. Together with the obligations to apply due diligence in production and comply with technical specifications, the obligation to cooperate could include the obligation to correct defects, with a view to correcting possible breaches. Under this perspective, the producer would be expected to request the necessary technical guidance to comply with the technical specifications, or to notify the contractor of any issues that may arise in relation with the performance of the obligation. The scope of the obligation to cooperate generally mirrors the contractor's obligation to cooperate. Linked to the obligation to apply diligence in the production and to cooperate, the producer can be expected to correct any default that arises, so as to mitigate damage. In

contractual practice, the obligation to comply with the contractor's instructions is sometimes only expressed in a general formula and such guidance is not detailed in the contract itself. This is not advisable, as it may expose the producer to be submitted to obligations which it did not have the possibility to understand and discuss before entering the contract. A more explicit formulation should list the different aspects on which the contractor's instructions will have to be followed. This listing draws the producer's attention to the wide range of instructions to which it will have to abide, yet it still can leave much uncertainty about their specific contents. Usually, however, contracts will go further and contain detailed provisions on several of these issues, with the necessary references to the contractor's corresponding obligations to supply inputs and technical assistance.

One specific obligation related to cooperation is to allow the contractor to visit the production site. Very often, agricultural production contracts provide that the contractor's representatives will have access to the fields, partly to give direct advice and partly to supervise the way the prescribed methods are implemented. Sometimes this is listed among the contractor's obligations. Actually the main obligation is for the producer to allow such visits on its premises, but the contractor also undertakes an obligation to give additional direct advice through such visits. When the contractor exercises broad control over the production, as part of the general expectations of the parties, best practices of contract farming may impose on the contractor a duty to help the producer meet the contract obligations and avoid unnecessary risks.

The contractor's **monitoring and verification** of the production benefits both the contractor and the producer. The contractor directly benefits by ensuring throughout the production that the final product will conform to the contract specifications. The producer concomitantly benefits by ensuring that the final product will be conforming. Through monitoring and verification, defects in producer's performance can be detected by the contractor early enough in the process to allow the producer to correct defects or improve compliance. To the extent that the contractor has superior knowledge to the producer, during the inspections the contractor may have a duty to inform the producer of noncompliance with mandatory obligations under the law, such as safety, labour or environmental legislation. This obligation would generally impose a duty on the contractor to assist the producer in correcting the defect.

Delivery and payment

Delivery is a key moment in the performance of an agricultural production contract. The contractor's obligation to take delivery of the goods, along with the producer's concomitant obligation to deliver the goods are basic obligations in any agricultural production agreement. These obligations are mutually dependent. It does not only involve obligations for both parties (one has to deliver, the other one to take delivery), but it may also be the source of important legal effects such as passing of title or transfer of risks, the extent of which depends on the applicable law. The contractor may also lose its right to exercise remedies for apparent defects if it does not make appropriate reservations upon delivery. Absent any contrary agreement, the producer's delivery is necessary to trigger the contractor's obligation to pay the price. The different aspects of delivery have to be organized by appropriate provisions in the agricultural production contract. Some contracts fail to do so, or they cover delivery matters in insufficient detail. Such lack of attention is apt to cause difficulties, which could be prevented by precisely organizing this important phase of performing the contract. It is also advisable to avoid clauses leaving it to one party to unilaterally determine the conditions of delivery.

OVERARCHING OBLIGATIONS

Irrespective of the particular obligations that arise from the agricultural production agreement, there are a number of obligations which may arise for one or both parties throughout the production cycle. A principal example is the general obligation on both parties for good faith and fair dealing. This obligation exists throughout the life of the contract, and includes a number of recurring potential problems in the contract farming relationship that often result in disputes. This includes early contract termination before the investments in buildings are paid off, the contractor requiring additional improvements at the producer's expense, the manipulation of the quality, quantity or cost of inputs such as birds and feed, the contractor's knowledge in

advance that contracts will be unprofitable, under weighing of poultry and feed, the failure to make payments or failure to make timely payments, false rankings under the system that the contractors use to pay producers and to terminate contracts, and retaliatory termination of contracts for organizing. Other notable overarching concerns include matters related to insurance, regulatory compliance and administrative obligations.

Excuses for non performance

After the conclusion of an agricultural production contract, the possibility may arise that some intervening cause either prevents one party from performing the agreement or renders its performance substantially more onerous. While this may happen for all types of contract, certain occurrences such as exceptional natural events can be expected to play a greater role in agricultural production than in other areas.

FORCE MAJEURE

Agricultural production is particularly vulnerable to specific external factors affecting the producer's ability to perform its obligations in relation to the product. Natural events such as floods or droughts, abrupt climatic changes, exceptionally high or low temperatures and insects or (other) plagues affecting crops are among the most common events that could destroy, in whole or in part, a producer's goods. Livestock can easily succumb to epidemics. Other possible supervening factors, while not as typical of agricultural production, may nevertheless influence the ability of either party to perform the contract. This is the case for non-natural occurrences such as changes in legislation or governmental policy concerning agriculture or applying more generally, which could be determined either at the national or international level; upheavals ranging from riots to revolutions or armed conflicts; and social events such as strikes affecting either the production process or the availability of transport and other facilities.

Though each legal system obviously employs its own terminology, force majeure has become a widely used concept. National laws generally – and exceptionally - provide for relief in the occurrence of events (as a rule, arising after conclusion of a contract) that are unpredictable, inevitable and beyond the reasonable control of the parties, and that objectively prevent one or both parties from performing. One may think of an exceptional flood which destroys all of the growing crops being raised under a contract on a specified plot of land. The typical effect of such an event, when recognized, is exemption from performance. Contractual parties are generally free to insert in their contract a specific provision on force majeure, however worded, rather than rely upon general principles that may apply under the governing law. Such clauses may serve the purpose of either restricting or enlarging the default rules of the applicable law.

CHANGE OF CIRCUMSTANCES

To be contrasted with events that make performance impossible, in the context of agricultural production contract practice, changing circumstances over the life of the contract may go beyond the risks contemplated at the time the contract was concluded. This may not necessarily impede performance, but rather profoundly alters the equilibrium of the relationship, and therefore constitutes a frequent ground for non-performance. Many legal systems do not contain specific provisions and, even where a rule does exist, its effects may differ greatly. Clauses expressly referring to a change of circumstances which would not prevent performance but merely render it more onerous for one of the parties are not typically part of an agricultural production contract. However, contracts do often contain price adjustment clauses which may refer to changes in the relative value of certain currencies, inflation, or other parameters in order to mitigate the effect of supervening factors. In addition, sometimes the terms "adverse factors" or "adverse events" are used without specifying whether they

should result in an impediment or in a mere difficulty to render performance in order to provide for an obligation to conduct renegotiations.

IMPLICATIONS AND CONSEQUENCES

It is important to note that issues of evidence are often overlooked by contractual parties, but they may well determine the outcome of a dispute in a relevant number of cases. Generally, the party whose performance is allegedly affected by the force majeure event bears the burden of proving the occurrence of said event, the required characteristics under the contract or applicable law, and the causal link between the event and the non-performance. Depending on the way the contractual clause is drafted, however, the burden of proof could be shifted onto the other party. Contracts may include more complex validation mechanisms such as the filing of a formal report to be submitted to and accepted by the other party (in particular, the contractor when the event is a natural catastrophe affecting the production), or even a decision by a local authority if parties cannot agree on the evidence. Parties may wish to recur to an external and independent source to provide evidence for the assessment of the existence of an event and the extent of a non-conformity of the product. For example, the exceptional or uncontrollable nature of a natural event could be subject to dispute. Inclusion of a certification by a meteorological station for storms or other exceptional climatic events may be required.

The recognition of a force majeure event may have different consequences. Under most jurisdictions the aggrieved party is exonerated from performing the obligation which is affected by the event. Under a less disruptive approach, often expressly provided for in agricultural production contracts, the obligation to perform is merely suspended for the duration of the impediment. Also, in an effort to reach a fair regulation, contracts may provide for mechanisms to redistribute the risk of a force majeure event affecting one party only (the producer), through the provision of (partial) compensation of loss by the other party. This may be restricted to a specific type of event (e.g. hailstorms), limited in time and/or applying only to specific contractual agreements (i.e. when the entire production was acquired). It may also consist of a redistribution of insurance compensations received by the contractor. Parties often incur additional obligations in relation to force majeure: several agricultural production contracts expressly provide for a notice requirement and contractual parties are advised to insert it in their agreement should they wish to introduce a force majeure clause. Also, certain contracts, for example, expressly provide for duties to exercise all due diligence to minimize the extent of the prevention or delay in the performance of the contract generally.

As a result of force majeure event, contracts, or, less frequently, national laws may grant the non-affected party (or the affected one) a right to terminate the contract. Parties may provide a right to request renegotiation or a duty to renegotiate the terms of the contract: renegotiation clauses are particularly useful when a long-term contract is concluded and parties wish to emphasize the importance of a continuous cooperation. Finally, the possibility for a court to intervene and adapt the contract to the new circumstances should be mentioned, while generally, this outcome is not favoured in national contract laws.

Remedies for breach

We see a general trend moving from product to process standards when evaluating performance, compliance and liability. The growing interdependencies of production contracts with the other contracts along the chain is reflected in a regulatory environment where sourcing policies, procurement policies, suppliers guidelines, framework contracts, certification and quality assurance schemes have come to play a significant function among legal sources in addition to the conventional parties' will, and domestic and international legislation. Both the boundaries between compliance and nonperformance and within each area (compliance and breach) have become more detailed and better specified, leaving less discretion to *ex post* interpretation. Contracts often define different levels of compliance correlated to different prices and markets. Similarly contracts identify

various levels of noncompliance with indicators of seriousness linked to different remedies and, in particular, the choice between cooperation and termination.

In relation to the producer, relevant variables for this analysis might include: i) the type of commodity (mainly crops v. livestock, perishable v. durable goods, etc.); ii) the type of contractual obligations (mainly whether product or process related obligations and whether linked with regulatory and compliance assurance schemes); iii) the structure of the contract (bilateral, multiparty, linked contracts), since it has relevant implications (1) on the type of liability and the party/ies with a right to seek remedies (e.g. liability for violation of the collective interest under the multi-party contract), (2) on the remedies and their effects (e.g. withholding performance by one party has a different and more relevant impact in a multi-party scheme, as well as different implications arise in case of damages evaluation and identification of the party against which damages may be sought for); iv) the existence of secondary or tertiary markets, given that it will influence the selection of available remedies and the calculation of damages.

The distinction between obligations functionally correlated to the production process and those related more specifically to the specific product is relevant for the selection of remedies. In the first instance, the focus is the process; in the second, the focus is product. Correcting process nonconformity may require changes which are more expensive and organizationally more demanding than correcting product nonconformity. Process nonconformity is relevant for contractors engaged in long-term contractual relationships with the producer. The differences emerge clearly in relation to the menu of available remedies and to their content, as in the example of corrective actions.

Hence, from the perspective of liability and remedies, we can distinguish at least three forms. The first form includes process-related obligations concerning activities only loosely related to nonconformity, as it is the case for social or some environmental standards or when they are connected with the production process, regardless of the specific commodity the producer has promised in the contract. Many obligations arising from certification or quality assurance schemes are process related but apply independently from the specific product to the production process. The second form includes process-related obligations that are strongly correlated to product conformity but maintain some degree of independence and give rise to separate breaches and specific remedies. Even within nonconformity there are separate obligations concerning the specific product and compliance with process-related obligations linked with nonconformity. Finally, the third form includes process-related obligations absorbed into product non conformity that only become relevant if there is product non-conformity, e.g. quality or safety requirements whose harmful characteristics only emerge at the end of the production process (experience goods). Other instances are obligations concerning the use of seeds, pests, fertilizers, that may be harmful to the environment, and compliance with agricultural practices that presuppose the use of specific agricultural techniques aimed at protecting the soil and its agricultural use. Often contracts require express contractor's approval. The standard to evaluate producer's non-performance is strongly linked with the fitness for ordinary or special purposes that the final product has to comply with. The content of remedies will reflect both the specificity of the obligation and the type of nonconformity.

With respect to the contractor, the main qualifying points are related to (1) the differences between those who provide inputs and those who buy the products with only indirect influence on input provision (2) the degree of guidance and control over the production process and the consequences in terms of liability and remedies.

Without comprehensive empirical research, at first sight production contracts are mainly self-enforced. Litigation is rare and parties solve disputes via amicable solutions, intermediaries, and self-executing remedies. Compared to general contract law and enforcement, damages play less a relevant role. The structure and objectives of production contracts require cooperative remedies that contribute to joint problem solving given the high amount of specific investments often associated with medium/long term contract duration. This approach is favoured also by the interplay with certification and quality assurance schemes whose noncompliance and remedial philosophy are also inspired by cooperation in order to preserve reputation and chain investments. Cooperative remedies may follow different logic depending on the type of nonconformity,

whether it concerns the initial inputs or the final outputs, whether alternative options are available within the chain or in the market. The type of commodity, in particular whether production involves crops, livestock, or aquaculture may also play some role. We distinguish cooperation within the contractual relationship, where for example, corrective actions have to be agreed upon between breaching and aggrieved party often with the contribution of certifiers or assurance scheme officers.

Duration, termination and renewal

In the context of agricultural production contracts, the issues of contract duration, termination and renewal are of great importance. These contracts by their very nature imply the carrying out of a continuous or periodic activity for at least one of the parties. It is therefore essential for the parties to know from the outset when their contractual relationship begins and ends. Equally important are whether and, if so, how the contractual relationship may be terminated prematurely and/or renewed when it comes to an end. Parties are well advised to specifically address these issues in their agreement. In fixing the duration of their contract and regulating its termination and possible renewal, parties should be aware that these issues are to a large degree interrelated: thus, for instance, the shorter the duration of the contract, the greater the need of providing in the contract for its possible renewal at the expiration date; conversely, the longer the duration, the greater the need of providing for the right of either party to terminate the contract prematurely.

DURATION

The explicit determination of the duration is common practice in agricultural production contracts, and may even be imposed by law. In determining the duration of their contract, the parties have to take into account the production cycle of the goods involved, as well as the parties' financial obligations. The latter are particularly relevant where the producer, in order to meet its obligations, has to make long-term investments such as the acquisition of specific equipment or the construction of new facilities. In order to be economically viable, such investments require a sufficiently long duration of the contractual relationship between the producer and the contractor.

With respect to the duration of the contract, parties may choose between two options. One option is to determine a fixed period of a rather short duration (so-called short-term contracts) and the other option is to establish a longer contract duration with or without a specified ending term (so-called long-term contracts). The reasons for choosing one option or the other mostly depend on the nature of the agricultural products involved and the parties' willingness to be bound over a short or longer period of time. Contracts for short-term crops such as vegetables and field crops are usually concluded on an annual or seasonal basis, whereas crops such as tea, coffee, sugar cane and cocoa require contracts of a longer duration. Also, livestock production and marketing contracts are normally stipulated to last for a longer period. More generally, parties will prefer a longer contract duration when they are interested in a solid and lasting relationship, particularly in view of the necessity of long-term investments. Additionally there may also be legislative limitations as to the maximum contract duration or required limitations due to interactions with land lease contracts.

TERMINATION

The term "termination" covers a great variety of situations ranging from the automatic termination of the contract at the expiry date or the fulfilment by the parties of all their obligations to the termination by either of the parties in the exercise of a right provided by agreement or by the law. The notion of "termination" is to be understood in a broad sense so as to cover virtually all cases where the contract is brought to an end, either

automatically or on the initiative of either of the parties. The more precisely that the parties regulate the possible cases of termination of their contract, the more stable and predictable their relationships will be.

When the contract is for an indefinite duration, or when termination is permitted under the contract before the expiry of the contract, a party intending to terminate the contract is normally required to give notice of its intention to the other party. In order to be effective, the notice has to meet certain requirements as to form and timing. In any event, it should be noted that the consequences of not providing notice in the prescribed form and/or time depend very much on the national legislation and the circumstances of the case. Thus, if the receiver of the notice does not object that it was not given in the form and/or within the time provided in the contract, it may be presumed that it tacitly agrees to derogate from the respective contract provisions. Yet even if the receiver rejects the improper notice, the terminating party may still serve a new notice in the prescribed form and/or accept that termination is postponed until the end of the prescribed notice period.

Termination of agricultural production contracts may occur for various grounds and in various forms. Apart from termination for breach, the most important grounds include: (a) automatic termination upon expiration of the established duration or the performance of contractual obligations; (b) termination by mutual consent between the parties; and (c) termination by one of the parties in accordance with special termination clauses. It is important to note that parties are well advised to expressly provide in their contract for some restrictions on early termination by the contractor, such as the duty to give notice of its intention to terminate the contract a reasonable time in advance, and the duty to reimburse the producer at least in part for the losses suffered due to the early termination. As a rule, the parties are released from their obligations to effect and to receive future performance upon termination. But, the accrued rights or liabilities survive termination, including the right to claim damages for non-performance.

RENEWAL

On arrival of the expiration date of a fixed-term agreement, the parties might be interested in the continuation of the contract. Parties are therefore well advised – and may sometimes be even required by law – to make express provision in their contract as to whether and, if so, how it may be renewed. Renewal clauses may provide for three different forms of renewal: (1) renewal by express agreement; (2) tacit or automatic renewal; and (3) renewal imposed by one of the parties.

Thus, parties may stipulate that their contract can only be renewed by an express agreement in writing and while normally the contract will be renewed with the same terms of the “old” contract, occasionally the parties may provide that within a certain period of time before the expiration date they will enter into negotiations with a view to renewing the contract and on that occasion possibly revise some of its terms so as to take into account relevant changes. Second, in short-term contracts it is quite frequent that parties stipulate that the contract is automatically renewed for further periods of the same or a different duration, unless one of the parties does terminate it by notice in writing within a certain period of time before the expiration date. Lastly and exceptionally, the contract may provide that only one of the parties, i.e. the contractor as being normally the stronger party, is entitled to extend the duration of the relationship, and that in case it decides to do so the producer must accept the renewal unless it makes some compensatory payments. Such unilateral renewal clauses may be considered unenforceable in some legal systems on the ground that they give the contractor an excessive advantage over the other party without any justification.

Applicable law and dispute resolution

The parties to agricultural production contracts typically undertake reciprocal performances over a period of time, during which many factual situations could lead to disagreements or affect the parties' mutual trust. The

risk of dispute may be higher when the relative economic powers of the parties are particularly unbalanced. Indeed, whereas the contractor may be avail itself of various remedies (e.g., withholding payments, terminating the contract or not renewing it), the producer may not be in an equally strong position to react to the contractor's breach or wrongful conduct, out of fear of contract termination or other forms of retaliation. Advocacy and collective action in support of individual producers in their dealings with contractors may have an important role to play, especially with assisting producers that face unfair situations and enforcing their rights.

APPLICABLE LAW

When a dispute arises, a key threshold issue which must be addressed is the applicable law of the contract. As opposed to the discussion relating to the legal regime applicable to an agricultural production contract under a particular domestic law, by referring to the "applicable law," this section refers to the identification of the legal system which will or may govern relationships under an agricultural production contract, including the legal situations deriving from such contracts. The law of the country and even the locality of the producer will most often govern the obligations of the parties under or deriving from an agricultural production contract. This will generally provide a reasonable solution in term of predictability of the applicable laws for the parties, especially the producer as the weaker party. However, under certain situations, a foreign law may indeed be relevant through its direct application to the contract, or for determining the content of the parties' contractual obligations.

Thus, most often, the legal relationships deriving from agricultural production contracts are strictly domestic in character, meaning that all of the elements of the contract are located in or produce effects in one single country. By their very nature, agricultural production contracts are indeed characterised by a strong relation with the person and the country of the producer. In most cases, the producer will be a national of, and domiciled or resident in the state, and the essential obligation under the contract (producing the designated commodity) takes place on the land or installations that are owned or controlled by the producer. A variety of other elements of the contract or related to the contract are likely to take place in or be related to this state. This includes, for example, the place of incorporation or registration of the contractor, which even when part of a multinational group will generally conduct its operations through a local subsidiary as a separate legal entity. It would likewise generally include the place where the contract is negotiated and entered into, where the agricultural products are delivered, and where the payment of the price is to be made.

DISPUTE RESOLUTION

While parties should normally make every effort to solve disagreements which might arise during performance of the contract, when the continuation of the contract or relationship is no longer possible or desirable, the priority becomes settling the conflict in the best possible manner, meaning based on a mutual agreement or by resorting to a third party who will settle the dispute on a fair basis, and with actual enforcement. During the course of an escalating dispute, parties will frequently first pursue amicable dispute resolution through direct **consultations**. If direct consultations do not adequately solve the dispute, parties may resort to mediation.

Mediation is where the parties seek a mutually acceptable solution with the assistance of a third person, and commit to apply it on a voluntary basis. Because of the benefits of mediation in providing a sound approach to disputes arising in relation with agricultural production contracts, most examples of specific legislation governing this type of contract provide for the submission of disputes to mediation. This requirement is a procedural guarantee for the parties ensuring that they are informed of their entitlement or obligation to resort to mediation, and would appear as a validity condition of the contract. If mediation fails to bring about a desirable resolution for both parties, they may choose to escalate the dispute further through resort to one of two possible options for binding dispute settlement: arbitration or judicial courts.

Under dispute resolution through **arbitration**, the parties refer the settlement of the dispute to a neutral third party, the decision of which will be binding and enforceable under the law. Disputes settled under arbitration

cannot be subject to a second settlement under judicial settlement. Parties have a large autonomy to agree on the modalities of the arbitration and the person of the arbitrator, and in that sense, arbitration shares a number of common features with mediation. However, since arbitration is an adjudicatory procedure and is intended to produce the same effects as a judicial decision, arbitration must be recognised and governed by a domestic legislation which contains a number of mandatory provisions, in addition to default rules. Under domestic arbitration, the arbitrator addresses the dispute based on the legal provisions of the applicable law. But, when entitled by the law on arbitration, and the parties have so agreed, an arbitrator may decide by relying on principles of justice and fairness.

If the parties have not pursued arbitration, the final stage in a dispute may be resort to **judicial courts**. Court proceedings are mainly regulated under mandatory law, generally with a high level of formality, justified by the need to ensure due process. In judicial proceedings, parties may be required to act through legal representation. Although professional representation will in principle help parties adequately present their case and defend their rights, it generally involves significant costs, which depending on the legal system may or not be recoverable by the winning party, and if so only after the final judgement. Under certain jurisdictions, legal aid delivered by public services could be available for people unable to afford such costs, so as to ensure the right to a fair trial and the right to counsel. Producer associations and other organisations may play an important role in providing advice and assistance to individual farmers in defending their rights in litigation. In most countries, public justice involves complex and lengthy proceedings, which may last for several years in civil and commercial matters. This generally acts as a deterrent for the parties to rely on the judicial system to obtain redress. Many countries are implementing reforms aimed at increasing justice efficiency, simplifying judicial proceedings, implementing electronic filing and administration of claims.