

**UNIDROIT/FAO/IFAD**

# **Legal Guide on Contract Farming**

## ***An Abstract Document***

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### **Project Partners**

UNIDROIT is an intergovernmental, Rome-based organisation that specialises in the harmonisation and modernisation of private law rules at global level, through international treaties and soft law instruments in several areas. UNIDROIT has earned widespread recognition for its activities in the area of contract law, in particular with the UNIDROIT Principles of International Commercial Contracts (2010), which are widely used in commercial practice and arbitration and as a reference in domestic legislative reforms ([www.unidroit.org](http://www.unidroit.org))

FAO promotes responsible contract farming by implementing domestic and regional development and capacity building programmes, issuing publications and maintaining a Contract Farming Resource Centre on the FAO website, which gives access to bibliographical references, contract samples and general legal documents ([www.fao.org/ag/ags/contract-farming/index-cf/en/](http://www.fao.org/ag/ags/contract-farming/index-cf/en/)).

IFAD – Based on its mandate to mobilise and deploy resources to alleviate rural poverty, and in furtherance of its priority objectives to promote the inclusion of smallholder farmers in agricultural value chains and to facilitate access to markets, IFAD actively supported the work to prepare the Guide since the outset. IFAD provided a grant that was instrumental in organising and implementing consultations on the draft Guide in 2014 ([www.ifad.org](http://www.ifad.org)).



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# UNIDROIT/FAO/IFAD Legal Guide on Contract Farming

## *An Abstract Document*

### *Presentation of the Abstract Document*

This abstract document prepared by UNIDROIT, provides an overview of the **UNIDROIT/FAO/IFAD Legal Guide on Contract Farming** published by the partner organisations in July 2015. 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 complete version of the Guide has.

The complete version of the UNIDROIT/FAO/IFAD Legal Guide on Contract Farming can be found on the UNIDROIT website at <http://www.unidroit.org/full-text-pdf>

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/aqs/contract-farming/index-cf/en/> .

## Introduction

Contract farming supports the production of a wide range of agricultural commodities, and its use is growing in many countries. Based on a contract farming agreement – an “agricultural production contract” –, the producer undertakes to produce and deliver agricultural commodities in accordance with the specifications of the contractor, which is typically an agribusiness company engaged in processing or marketing activities. The contractor, in turn, undertakes to acquire the product for a price and generally has some degree of involvement in production activities through, for example, the supply of inputs and provision of technical advice.

Mindful of the importance of enhancing knowledge and awareness of the legal regime applicable to contract farming operations, 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) have prepared the *UNIDROIT/FAO/IFAD Legal Guide on Contract Farming*. The Guide is the product of a Working Group, set up by UNIDROIT, which brought internationally-recognised legal scholars, partner multilateral organisations, and representatives from the farming community and agribusiness together. Stakeholder representatives, international civil servants, practising lawyers and academics from different backgrounds and legal cultures have contributed to the process of development of the Guide, and valuable input was received during consultations held during 2014 with stakeholders in Buenos Aires (Argentina), Addis Ababa (Ethiopia), Rome (Italy) and Bangkok (Thailand), as well as through online consultations. At the end of a two-year development process, the UNIDROIT Governing Council considered and adopted the Guide at its 94<sup>th</sup> session, held in May 2015.

## Purpose of the Guide

The Legal Guide on Contract Farming is primarily addressed to parties to a contract farming relationship, *i.e.* producers and contractors. It provides advice and guidance on the entire relationship. The Guide provides a description of common contractual terms and a discussion on legal issues and critical problems that may arise under a variety of practical situations. It illustrates how these problems may be treated and are regulated under different legal systems. In so doing, the Guide aims to promote a better understanding of the legal implications of contract terms and practices. Contractual advice or recommendations may be provided, as a result of analysis and discussion, when considered meaningful. Under this perspective, the Guide intends to promote a more stable and balanced relationship in order to assist parties in designing and implementing sound contracts and develop good practices, thereby generally contributing to the creation of a conducive environment for contract farming.

This Guide does not interfere with mandatory domestic rules; nor does it intend to provide a model for, or encourage the adoption of, special legislation. It is however acknowledged that, to the extent that the Guide identifies problems and highlights possible workable and fair solutions, it could also provide useful information for policymakers. The Guide could be recognised as a reference for good practice by reflecting a baseline internationally-accepted standard of practice in contract dealing.

The Guide intends to provide practical guidance to international organisations, bilateral cooperation agencies, non-Governmental organisations, farmers' organisations, professional organisations, judges, arbitrators, legislators and mediators. Although primarily focused on legal considerations in the negotiation of agricultural production contracts, the Guide also lays the groundwork for consideration of policy aspects.

## Scope of the Guide

The Guide recognises the broad economic definition of contract farming as *"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."*<sup>1</sup> Under this concept, contract farming focuses on the coordination between the different parts of a supply chain, involving a variety of participants and contract modalities.

While keeping the value chain management system in mind, the Guide however focuses more precisely on the bilateral relationship between the producer and the contractor, referred to as an "agricultural production contract". Under the Guide, the producer is an independent person or undertaking with a direct involvement in the production of agricultural products, and the contractor, typically an agribusiness company engaged in processing or marketing activities, is committed to purchase or take delivery of the products. The contractor very often also provides both physical and intangible inputs. Contract farming, more importantly, envisages legally independent contractual parties, unlike relationships such as partnerships or employment. Other entities, such as non-governmental institutions, are often interested and influential in the contract. The agricultural production contract

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<sup>1</sup> Da Silva, C.A. 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.

organisations (NGOs) or banking itself is entered into before production begins, and is generally for a fixed term, with a view towards building a continuous relationship throughout multiple succeeding contracts.

## Various contract farming operations in practice

Contract farming can take multiple forms. It may be vertically-coordinated to a greater or lesser degree, ranging from multiple complex written contracts between a contractor owning and managing a plantation and producers, to an individual entrepreneur contracting verbally with a small-scale producer for a single season. Contract farming can be used for any crop or livestock commodity, however it is seen as particularly useful for labour-intensive, identity-preserved and perishable commodities due to its increased guarantees of safety and quality. It is also used for commodities for textile and chemical industries, and commodities intended for animal consumption.

## Benefits and risks of contract farming

Contract farming can be an effective risk mitigation tool for between parties, and may lead to many mutual and separate advantages. Contract farming allows the contractor to optimise operations by securing a steady supply of quality products, following a precisely requested processing method, without having to acquire land. Contract farming also 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. A successful contract farming arrangement can protect both parties from market fluctuations by providing certainty and stability. Moreover, contract farming can also have wider positive economic, social and environmental advantages, not only for the parties but also for the community at large.

However, 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, an example being the producer selling the products intended for the contractor to a third party, because the market price is higher than the contract price (a practice called *side-selling*). Generally, and, to an even greater extent, in less-developed countries, obtaining enforcement of the contract may be problematic due to inadequate judicial proceedings.

# 1. The Legal Framework

## 1.1. The applicable private law regime

The contract farming relationship is built on the guiding principle of freedom of contract. This freedom may be limited by mandatory rules under applicable law. Applicable law also sets forth default rules, which provide solutions when the parties have left open terms, or when their intentions need to be interpreted.

The domestic law of the producer's place of production most commonly governs the agricultural production contract. Some legal systems treat the agricultural production contract as a special type of contract, governed by a separate statute in general contract law, or by a specific law of its own. In general, specialised legislation aims to protect the producer, and encourages stable

relationships by setting specific requirements on the form and substance of the contract and restricting unfair practices. Such law invariably requires a written contract, which allows the producer to better ascertain its risks and obligations, and often requires the parties to subject themselves to a dispute-resolution mechanisms.

In some legal systems, other forms of contract laws may apply to agricultural production agreements in the absence of specific legislation on contract farming under governing law. Such contracts can either be classified as transfer of ownership, amounting to a sale transaction, or contract for services, for example, or other types of contracts, depending on the particular legal system. Because the variety of obligations it entails, the agricultural production contract may be considered of a type of contract unto its own.

Regardless of their legal characterisation, all agricultural production contracts are subject to public policy limitations that aim to protect overriding social and economic interests, and such rules can emerge from a number of sources. A first set of such rules will derive from the principles of law. General contract law usually regulates the most fundamental aspects of the contract, such as formation, validity, non-performance and remedies to mention a few, and consequences of their breach. Similarly, legislation on torts and legal capacity, for example, play an important, if indirect, role. The general principles recognised by the particular legal system have a broader scope and are fundamental in providing guidance to the parties. In particular, the principle of good faith, where recognised, might have far-reaching implications as it can form the basis of a number of obligations. Application of these principles may vary from one legal system to another.

Secondly, customary rules can offer guidance if recognised by the applicable law. These rules are rarely codified and frequently arise from local and/or indigenous communities. Customary rules may be taken into account to help create a trustful relationship with the producer. Similarly, usages, which are regularly observed practices in an industry and are often codified, should also be taken into account. Neither of these should be unreasonable nor contrary to the law or express terms of the contract, and burden of proof on the existence of the rules lies on the invoking party.

Finally, standard terms and guidance documents can act as a source. These model contracts, codes of ethics, good practices and other forms of soft law can come from both the private and public sector. They often cover technical requirements regarding the quality and safety of the product, and may be made binding by government regulations or by having reached the status of customary rules. Especially in common law countries, all of these sources are further interpreted and supplemented by judicial interpretation from various levels of courts.

## **1.2. The role of the regulatory environment**

The parties will also be subject to a number of public laws and regulations that will influence the formation and implementation of their contract, particularly regarding technical specifications. These influences can derive from *e.g.* international trade law, competition law, food safety and conformity assessment procedures legislation, as well as labour law. Domestic rules also apply to the various kinds of inputs, which are an important part of agricultural production contracts.

International human rights set their own limitations and offer guidance for contract farming not only for states, but also for businesses. Participation, accountability, empowerment, non-discrimination, transparency, human dignity, and the rule of law are some of the most important general rights in relation to contract farming. Right to food has an especially important role, as contract farming may lead to monoculture, undermining food security. Similarly, agricultural production contracts need to ensure the role of vulnerable parties, especially women.

## 2. Parties to the Contract, Contract Formation and Contract Form

### 2.1. Parties to the Contract

In the simplest form of contract farming, a single producer enters into an agricultural production contract with a single contractor. It is possible for other entities to participate in the same contract, creating a multiparty contract. Third parties can also affect the contract through separate but linked contracts, *e.g.* through sale of inputs.

Producers may participate in contract farming either as individuals or through producers' organisations. In its simplest form, a producer will individually produce under a contract, carrying all risks and forming a single entity in his personal and professional capacity and assets. Similarly, a group of people may form a partnership with a joint and several liability, sharing both profits and losses. An individual producer may also incorporate, setting up an independent legal entity, separating the owner's personal assets from the company's assets, and distancing itself from personal risk.

It is possible for producers to form an organisation, to join resources without losing their individual autonomy. Working as a group entails advantages related to economies of scale. These groups can also take on a role of strong advocacy, empowering individual producers to better negotiate their contracts. Helping producers join these organisations is widely viewed as a good practice because of these often beneficial effects.

One may generally categorise producer organisations as either non-profit entities or cooperatives. The former aim to enhance the capacities of their membership by providing services and facilitating dealings with contractors or third parties. Domestic law often allows them to be a party to production contracts, however, as non-profit entities, they cannot distribute profits. Cooperatives on the other hand combine commercial and not-for-profit features, thereby offering the same services as the non-profits, but also participating in marketing, pre-processing, developing of specialised products and other forms of downstream acts.

Under the Guide, the contractor is the party commissioning the production from the producer and providing inputs, guidance, and/or control. The contractor is often a private business entity, operating on a commercial basis. However, due to the flexible nature of contract farming, a wide range of companies can be contractors. Likewise, it is possible for public entities to participate as contractors, though most often they tend to deal through a private partner, by setting standards and requirements for procurement.

Other parties may hold an interest in an agricultural production contract. Different value chain participants may contribute to the process through various institutional or contractual linkages. These linkages can be strong and direct, such as in a multiparty contract, allowing direct interventions, or more remote, such as in a separate agreement aimed at achieving the goal of the original agricultural production agreement, *e.g.* the employees of the producer. Sometimes these interventions of specific third parties are either required or provided by the contract, requiring for example the producer to procure certain forms of inputs from an identified buyer. Other interested parties include the possible land-owner and the creditors of the contractor.



## 2.2. Contract formation

As for any agreement, the agricultural production contract is formed by an offer and acceptance. The process of formation - negotiations, preliminary exchanges of information, delivery of an offer, acceptance of the offer and the making of the contract proper - has a crucial impact on the contractual relationship. All stages of formation should be conducted fairly, in a transparent manner, and in good faith.

Offers are usually made by the contractors, and best practices require them to be made in writing, allowing the producer time to think and consult before accepting. The offer must be sufficiently descriptive for the binding intentions to be established clearly. Some measure of vagueness can be based on past practice or principles of good faith, fair dealing and reasonableness. Written offers can usually be supplemented by oral explanations. In some cases, negotiations can even continue after the acceptance of the offer for individual clauses. Replies to offers that contain additions, limitations or other modifications are generally viewed as counteroffers. Some legal systems impose additional requirements for acceptance.

Both the producer and the contractor must have the legal capacity to enter into the contract. Because lack of informed consent may render the contract voidable, it is of paramount importance to ensure that the producer understands the contract properly. Allowing third parties to participate in the negotiation would facilitate this purpose, as would the contractor's explanation of the details to the producer in a comprehensive and understandable manner. It is in the contractor's own best interest to act in a transparent way and to provide relevant information on the obligations, risks and circumstances to the producer, in order to help the producer give informed consent. If acceptance is reached through fraud, mistake or duress it may render the whole agreement voidable.

It is often beneficial to allow third parties to participate in the contract formation to facilitate a fair and balanced contract. Producer organisations especially can help overcome the asymmetry in negotiation power between a producer and a contractor. Many other entities, such as governments, NGOs, development agencies, agents of the parties, and other individuals, can also assist in setting mutually advantageous conditions. Sometimes sector-specific legislation may even require public entities to monitor the formation of and register the contract.

## 2.3. Contract form

As a general principle, contracts are not subject to any requirements as to form or content. As with the offer, a written contract is highly recommended. A written contract improves clarity, completeness, enforceability and effectiveness and is more easily understood, especially when written in terms and language understood by both parties. The written form is required by specific legal provisions that regulate contract farming.

Freedom of contract allows the parties to use standard terms to lower transaction costs. As these terms often come from the contractor, the balance may tilt in its favour. This, combined with the producer's lack of economic freedom to negotiate, might drive producers to enter into legal contracts that are economically imbalanced. As mentioned, third parties can bridge this gap. If the contract is fundamentally imbalanced, the affected party may often avoid the contract or ask a court to modify it.

## 3. Obligations of the parties

The parties' obligations are often interlinked. The producer's main obligation is to produce the goods following the specifications given in the contract by the contractor. The contractor's main obligation is to then either purchase or take delivery of the product and pay the price to the producer

### 3.1. Risk allocation

The obligations of the parties under the contract are intrinsically related to how the parties intend to allocate and compensate for risks. Risks may broadly be categorised as either production risks or commercial risks. Production risks are disruptive events that may take place during the production phase, negatively affecting either the quantity or quality of the crop. Which party bears the risk of loss is typically regulated by the contract or domestic legislation. Most often, the risk and some rights are carried by the party with the title to the goods, which usually passes with the transfer of ownership.

Commercial risk refers to a situation where production cannot generate the expected revenue due to changes in market price or demand for the commodity. Controlling commercial risk is a basic motivator for the contractor to participate in contract farming, and to do so the contractor often engages in close supervision of the production or requires exclusivity from the producer, restricting the producers' ability to deal with other buyers. When exclusivity is required, the producer loses much or all of its economic autonomy in exchange for a guaranteed market. A rigid exclusivity clause can prompt side-selling, when the market price at delivery time is higher than the pre-established contract price.

### 3.2. Quantity and quality of the product

The producer has the obligation to produce and deliver conforming goods, which is generally linked to the contractor's obligation to provide the proper quantity and quality of inputs. The extent of each party's obligations for the provision of inputs and the production methods determines the risks that each party assumes for loss, shortage or poor quality of the commodity.

Parties can contract either the whole production or a part of it. Contracting for the whole production implies exclusivity. Whilst contracting a specified part of the production allows the contractor to have greater control over the quantity of its supply, it places a risk of underproduction on the producer. On the other hand, the producer, possibly subject to the contractor's right of first refusal, would normally be free to sell the excess part of his production to a third party.

The specifications for the quality of the product can come directly from the contract itself or they can stem from public policies, under health and/or safety regulations. Quality requirements can be directed either at the final product or at the production process. The guidance given by the contractor during the production process might influence the quality requirements. In all cases, the product should fulfil reasonable expectations and be fit for the general purpose, alongside any particular purpose known by the producer.

Sometimes an obligation for the producer to become certified is included in the contract. Certification schemes may contain performance monitoring, and may allow early detection of non-conformity.

### **3.3. Production process**

Agricultural production contracts typically provide for obligations on how the production process should be carried out. These questions can be divided roughly in two categories: provision and use of inputs and production methods, compliance and control.

#### ***3.3.1. Inputs***

The concept of inputs encompasses both physical inputs, such as seeds and pesticides, and intangible ones, such as advice and know-how. The allocation of responsibilities for inputs varies between the parties, and can be based on express and implied contract provisions, default rules from the law and industry practices. Inputs are often provided by the contractor, who is generally in a better position to acquire high quality inputs. The producer can also be required to obtain inputs from a third party. If a third party fails to provide the required inputs or provides defective ones, the liability of the contracting parties will generally depend on their sphere of control over the third party.

The producer's obligations relating to the inputs include receipt, ascertaining conformity, notification of defects, caretaking, bearing the risk of loss, use according to instructions provided, and payment. Certification of the quality of inputs by an independent third party would be advisable if possible. Although the contractor often provides most of the inputs, the producer frequently owns, or at least controls, the land on which the production takes place and provides the workforce.

Very often, the contractor recovers the price of inputs by deducting it from the final price to be paid to the producer. The agricultural production contract is thus used as a credit vehicle, offering delivery of inputs on credit. The contractor may also provide finance (either directly or facilitating third party financing), or provide various services in relation to the production, to be performed according to the standards derived from the contract, regulations or professional standards.

Intellectual property rights, usually held by either the contractor or third parties, are a prime example of information asymmetry between the parties, and might require extra attention in contract negotiations. Relevant IP-rights include, for instance, patents, plant variety rights and trademarks.

#### ***3.3.2. Production methods, compliance and control***

Compliance with quality obligations upon delivery often requires compliance with specific methods during the production process. These requirements can stem from the contract, mandatory legislation or private standards. These methods can either be expressly stated or implied in the contract. They can focus on the final result, or may require the use of skills, diligence and best effort. Often, requirements of cooperation may play an important part requiring mutual assistance. In order to allow the contractor to fulfil its obligation to monitor and control production, the producer may have to provide access to its production site for the contractor.

When the contractor has a broad control over the production, it might also have a duty to help the producer meet the imposed obligations and avoid creating unnecessary risks. This might imply a more general duty of cooperation, which would result in the requirements of fair behaviour, timely and diligent action to support, communication and providing advice.

### **3.4. Delivery**

Delivery is a key moment in the performance of a contract. The contractor's obligation to take delivery of the goods and the producer's concomitant obligation to deliver them are basic obligations in any agricultural production contract. Title to the goods, as well as associated risks generally passes

from producer to contractor upon delivery, which often triggers the contractor's obligation to pay the price.

Delivery requires the contractor to examine the product and, in the absence of objections, the contractor will lose its right to remedies for some apparent defects. It is good practice to allow the producer or a third party to be present when weighing the product, as this can foster trust in the contractual relationship and evidence of the conforming delivery. Domestic legislation often contains default rules related to delivery, but the procedure is almost always also specified in the contract due to its utmost importance. This procedure includes the definition of time, with or without flexibility, and place of delivery as well as the mode of acceptance.

### **3.5. Price and payment**

The contractor's main obligation is to pay the agreed price for the goods or services delivered by the producer. Failure to set the price or a mechanism for setting the price, might render the contract unenforceable. Good contract practices would allow the producer or a third party to participate in the calculation of the price term. Parties may provide for possible renegotiations of the price throughout the duration of the contract.

In the absence of government regulation on the price, the parties can choose the price mechanism. Price mechanisms can be roughly divided into two categories, fixed prices and price scales. Fixed prices are determined at the time the contract is entered into, either as a fixed amount, or holding that the market price at the time of delivery will be the contract price. The former option may provide greater certainty, but may incentivise breach of contract if the market price is significantly higher or lower at the time of delivery. Market price can accurately reflect the price the parties would have chosen had they known it at the time of signing the contract, but this renders the parties vulnerable to price fluctuations.

Price scales usually fix a set price and then offer a premium, to be adjusted based on the quantity and/or quality of the product and sometimes efficiency in production. The scales can be modelled either as incentives or penalties for the producer. Scales in general create incentives for good quality and quantity, creating a win-win situation for both parties. Sometimes the complexity of these clauses can lead to confusion and allow manipulation. As always, transparency and clear price terms benefit both parties by fostering trust and creating certainty.

Finally, the timing and method of payment should also be specified. If the payment is supposed to occur after time has passed from delivery, it might expose the producer to additional risks relating, for example, to the contractor's subsequent insolvency.

### **3.6. Additional obligations**

Besides core obligations, the parties might have additional obligations such as obtaining insurance, keeping records and managing information or taking into account community interests. It is also good to bear in mind that the parties are not allowed to transfer their obligations without the consent of the other party or an explicit clause in the contract to that effect. Transferring of rights is generally allowed.

## 4. Excuses for non-performance

### 4.1. Supervening events

After entering into an agricultural production contract, some intervening cause might prevent one party from performing the agreement or render its performance substantially more onerous. The former case, also known as *force majeure*, is often defined as an event that is unpredictable, inevitable and beyond the reasonable control of the parties - objectively preventing performance by one or both parties. This situation is generally considered as an excuse for non-performance. The latter case refers to a change of circumstances that may not necessarily preclude performance, but fundamentally alter the balance of the relationship, and is acknowledged as an excuse for non-performance to varying degrees by different legal systems. Since the underlying event is often very similar, distinguishing these two excuses is generally a matter of interpretation.

Some types of supervening events are especially important for the performance of agricultural production contracts. Natural events such as floods, droughts, insects or plagues, which might destroy the producer's goods, are often taken into account in the contract. Importantly, it might be difficult for the producer to prove these events are beyond the realm of agricultural risks, especially in the case of pests, if the contract has required the use of pesticides. Other possible cases, though less common, involve new government legislation, riots and strikes affecting production or transportation. Given the generally medium to long duration of an agricultural production contract, and the fact that parties typically undertake to make periodic or deferred performances, there is an enhanced likelihood of supervening events taking place.

The parties are generally free to allocate the risks arising from these supervening events through *force majeure* clauses in their contracts. Exercising this freedom does not necessarily displace the rules set in the applicable law. Because of the flexibility of the *force majeure* clause, it is sometimes hard to distinguish it from clauses limiting liability the use of which is often restricted by the domestic law.

### 4.2 Consequences of the recognition of *force majeure* and change of circumstances.

When a supervening event contemplated by a clause on *force majeure* or change of circumstance in the contract has taken place, and the burden of proof lying on the party relying on the excuse has been discharged, the aggrieved party is generally exonerated from performing the obligation affected by the event. Often the producer would still be liable to repay the inputs, in the absence of a specific contractual clause to the contrary. If the law or the contract allow it, performance may be suspended for a certain period of time, after which the performance is considered excused, the non-affected party allowed to terminate, or the parties are to renegotiate the terms of their agreement. Renegotiation or termination can also take place immediately after the supervening event, if allowed by contract and applicable law. Finally, the courts could intervene and adapt the contract to the new circumstances, though this is a cumbersome and rarely invoked option.

While domestic legislation seldom requires the affected party to give a notice of the event, it is a common feature in legal instruments applicable at the international level. The supervening event itself might also make delivery of such notice impossible. Contracts may also require due diligence to minimise the damages caused by the event. Failure to send notice might prevent reliance on the excuse, while failure to minimise might give rise to an autonomous right to damages.

## 5. Remedies for breach

### 5.1. General aspects and principles related to remedies

Remedies are any legal measure provided by law or by contract to protect the interest of an aggrieved party against the other party's non-performance. Within the limits provided by applicable law, the parties are free to select remedies, to define their hierarchy and sequence, and to limit them in different ways. It should be noted that the primary objective of remedies may not always be to provide the aggrieved party with redress. Ideally, a well-conceived remedies system should ensure compliance with performance standards, not only by discouraging breach (through the threat of liability, termination or other adverse consequences), but also by encouraging performance (through facilitation of proactive error detection and correction).

The choice of remedies varies according to the type of breach, either relating to process or product non-conformity. It also depends on whether the obligation is instrumental for the performance of other obligations. For remedies other than damages, the existence of breach is sufficient to entitle the aggrieved party to seek remedy. In the case of damages, the aggrieved party generally has to prove the breach, the harm and the causal connection.

Besides judicial remedies, it is important to bear the possible market and social sanctions that can work alongside one another in mind. Within the limits provided by applicable law, the parties are free to select their remedies, to define their hierarchy and sequence, and to limit them in different ways.

### 5.2. Different types of contractual remedies

Remedies can be broadly divided in three different categories: (1) remedies in kind, providing the aggrieved party with the same benefit expected from contract performance; (2) remedies providing monetary value replacing the missing benefit; (3) and termination combined with monetary redress, when the fundamental nature of the breach leaves no room for continuing the contractual relation.

Remedies in kind include the right to performance, repair, replacement and corrective actions, and aim to achieve the desired contractual results, or a cooperative second best solution. Applicable law might sometimes restrict the remedy of specific performances in regards to non-monetary obligations, when performance would be physically impossible, unreasonably burdensome or legally unenforceable.

Withholding performance is a form of remedy that can be used when the breach has already occurred and the aggrieved party has not yet performed its obligations or, in the case of an anticipatory breach, when circumstances make it apparent that there will be a fundamental breach.

Price reduction stands between contract adjustment and remedies. Even when the contract lacks a specific clause on the matter, applicable law may allow the aggrieved party to reduce the price based on the non-conformity of the product or input or the partial delivery of either. Price reduction can be barred by the right to cure defects if allowed by law, unless unreasonable.

Termination is the most severe of remedies, ending the contractual relationship either completely or in part. As ending the relationship rarely satisfies the aggrieved party, termination is frequently combined with damages. Domestic legislation often requires the breach to be fundamental. Legal systems may differ on the procedure required to terminate a contract, ranging from a court claim to a written notice served within a reasonable time after becoming aware of the breach.

Restitution requires the parties who are not entitled to retain goods or money by contract or by law to return them to the entitled party. Physical impossibility can prevent restitution, transforming it to

an obligation to pay back an equivalent amount of money unless the impossibility of restitution is caused by the party requesting restitution.

Damages can be used as a standalone remedy or in combination with other remedies. If used as a standalone remedy, damages aim to put the aggrieved party in the position it would have been in had the contract been performed correctly, or, in the case of reliance damages, to cover expenditures made in preparation for performance. Full compensation is often allowed, covering both incurred losses incurred and denied gains, subject to the limits of foreseeability by the breaching party. Pecuniary obligations are often combined with the payment of interest, if allowed by the applicable law.

If the aggrieved party contributes to the breach or fails to mitigate the negative consequences arising from it, the selection of remedies might be limited and recoverable damages lowered according to degree of fault and causal link. In the same cooperative vein, renegotiation after the breach might preserve material and non-material investments, and better align the remedies with the parties' interests.

### **5.3. Contractor remedies for breaches of the producer**

For breaches of the producer in process-related obligations, the contractor may have recourse to remedies in kind, termination and damages. As for remedies in kind, the contractor can exercise its right to performance, for example to ensure the producer's compliance with the process standards. The contractor can also require the producer to take corrective actions, often determined by an agreement with the contractor. Termination is an exceptional remedy for breaches of process related obligations, because these remedies usually aim to sustain the contractual relation, rather than ending it. Similarly, damages are less relevant as a standalone remedy but they may play an important complementary role.

The same categories of remedies may also be available for the producer's breach of product conformity obligations. The use of remedies in kind depends on the time of detection of non-conformity, with a decreasing possibility to correct failures as the time passes. If detected early, the contractor can require corrective actions, but later on repair might be more suitable. If the non-conformity is detected after delivery, or the previous remedies are not viable, the contractor can require replacement. If non-conformity is severe enough to be a fundamental breach, the contractor might require termination of the contract combined with damages. Damages might also be a standalone remedy. Finally, depending on applicable law, price reduction can be applied to product non-conformity

Similar remedies can also apply to the producer's failure to deliver the product. The producer may completely fail to make the delivery, the delivery can be delayed, delivered at the wrong location, or the producer might only deliver a portion of the agreed amount. As for remedies in kind, requesting a performance is a suitable remedy, especially when the products are subject to specific requirements. Because termination often requires the breach to be fundamental, it can generally only apply in cases of total lack of delivery. Damages can be used to cover the costs incurred by delay, or to recover the difference between contract price and market price when termination is used. Withholding performance is a natural remedy against delivery related breaches, when payment is due after the delivery. Finally, depending on applicable law, price reduction can be applied to product non-conformity.

In some systems, the contractor can also use monetary penalties attached to obligations to induce compliance. Similarly, prohibiting the producer to further enter into a new contract within the same supply chain, or blacklisting and publicising the breach to the whole market potentially preventing the producer from entering into any new contracts with other supply chains, can sometimes effectively motivate the producer to perform its obligations.



## 5.4. Producer remedies for breaches of the contractor

The producer can choose from many remedies for a delay or a failure in payment. Firstly, the producer can assert its right to performance, and formally request the contractor to pay the delayed price. Besides opting to use executory judgments and trying to seize the contractor's goods, the producer might be assigned a first priority lien over the goods owned by the contractor if the applicable law allows this. If the payment is sufficiently late to turn the breach into a fundamental breach, or if there is a valid reason to anticipate a fundamental breach, the producer might decide to terminate the contract and claim damages. Failure to pay the price also gives the producer a claim for damages.

The choice of remedies available for non-conformity of inputs depend on the time of detection. If defects are detected upon input delivery, or afterwards but before output delivery, the producer might be in the best position to inspect the inputs and notify of any non-conformity, late or failed delivery. With the notice, the producer could ask for instructions on how to mitigate the consequences and insist on either specific performance or replacement. Alternatively, the producer could engage in a cover transaction. If corrective measures do not obtain the desired outcome, or the corrective measures are impossible to perform, the producer may opt for termination supplemented with damages. Damages usually play a minor role as a standalone remedy.

The contractor's failure to take delivery gives rise to a number of remedies available to the producer. Requesting the right to performance is especially useful when commodities deteriorate fast, unless taking delivery is physically impossible or unreasonably burdensome. Alternatively, the producer can take reasonable measures to sell the goods. If the contractor specifically expresses its refusal to accept conforming goods, or there is a significant delay, the breach may be deemed fundamental, and the producer has the right to terminate the contract. Furthermore, the producer can also claim either expectation or reliance damages.

Whenever the contractor's breached obligation is due before the producer's obligation or simultaneously, the producer can pressure the contractor to perform by withholding performance. Applicable laws and contract provisions may limit the applicability of this remedy somewhat, either because of the lack of economic power or because its use is inappropriate for the operation of the production schedule.

## 6. Duration, renewal and termination

### 6.1. Duration

The issues of contract duration, termination and renewal are of great importance in the context of agricultural production contracts, since they imply, by their very nature, the carrying out of a continuous or periodic activity for at least one of the parties. For this reason, an express clause on duration is a common feature in many contracts, but quite rare in domestic legislation. Agricultural production contracts can range from a short duration, usually expressed as a number of months or with a reference to a crop season, to a long-term contract, which either specifies a longer period of several years, or simply leaves out the end term. The choice of duration depends on both the commodity and the willingness of the parties to be engaged in a long relationship. The duration should also mirror the financial obligations, especially when the producer has made a specific investment, and be enough to cover them. Longer-term contracts, by their very nature, should to a greater extent foster trust and confidence and imply an ongoing duty to cooperate compared to short-term relationships.



## 6.2. Renewal

Contract renewal may occur in several ways after the foreseen duration. The contract might stipulate that renewal is only possible by express mutual agreement in writing. In the case where the parties renew the contract orally or by mere conduct despite such a clause, the general principle prohibiting inconsistent behaviour might prevent them from invoking the clause subsequently. The contract might continue under the same terms or be subject to renegotiations. Even in the absence of such an explicit provision, the contract may also be renewed tacitly or automatically, and in such cases string together a multitude of short term contracts, to form a single long term. The contract might provide for renewal at the option of one party, requiring perhaps compensatory payments if the other party refuses to accept. There is a strong possibility however that these types of unilateral renewal clauses might be found unenforceable by the courts on the grounds that they give one party an excessive, unjustified, advantage over the other party.

## 6.3. Termination

“Termination” covers a variety of situations ranging from automatic termination of the contract at its expiration date, to the fulfilment of all obligations by the parties, to the termination by either party by exercising a right provided by the agreement or by law. A termination clause, as recommended by several examples of national legislation, creates a more stable and predictable relationship. Termination is often subject to a notice requirement, usually to be provided in writing in advance of the final termination.

Besides being a remedy for contract breach, termination can occur on various grounds and in various forms. First, the contract can be terminated automatically at the end of the fixed term, or when both parties have fulfilled all their obligations. Naturally, the parties may mutually agree to terminate the contract at any point if they wish to do so. There may be a special termination clause, giving one or both parties the right to terminate the contract, subject to further conditions, though unilateral termination by only one party could be deemed unenforceable. Finally, termination may occur for a just cause, such as a radical breakdown of trust, making the continuation of the contractual relationship undesirable. It is advisable for the parties to draft a definite clause for this possibility.

Upon termination, the parties are released from their obligations to perform and accept performance, whilst retaining rights and liabilities. Some clauses, regulating settlement of disputes or confidentiality for instance, might endure after termination, and the parties would do well to specify this in the agreement.

# 7. Dispute resolution

## 7.1. Disputes and dispute resolution in agricultural production contracts

When negotiating and drafting the contract, the parties are advised to envisage a method to resolve disputes they may not be able to solve directly, providing for the intervention of a third party. While parties may always bring their claims before a court, alternative dispute resolution procedures need to be considered, as they may be more appropriate with regard to the nature of agricultural production contracts.

Before resorting to dispute resolution mechanisms, the parties should try to solve their issues through negotiations. Certain factors such as the price, speed, confidentiality and guarantee of same opportunities might influence the parties' choice of a dispute resolution method. In general, the methods can be divided into either non-judicial or judicial dispute resolution, the former encompassing amicable dispute resolution and arbitration, and the latter consisting of more traditional court proceedings.

## **7.2. Non-binding alternative (amicable) dispute resolution**

Mediation is one of the most flexible forms of amicable dispute resolution. In mediation, the parties try to reach a mutually acceptable solution with the help of a third person. Due to its lack of procedural requirements, the parties can organise the mediation according to their wishes; it can be used early on in the dispute, quickly and at a low cost. Mediation can also be scaled to fit all sizes of problems. It is guided by principles of fairness and justice, and will consider the circumstances surrounding the dispute. Mediation does not provide a readily enforceable decision, but is contractually binding on the participants. The parties are advised to draft a detailed clause both expressing the determination to mediate and providing either an institution or a method of appointing a mediator. The choice of a pre-existing institution could guarantee neutrality, effectiveness, impartiality and the competence of the mediator.

## **7.3. Arbitration**

The second form of non-judicial resolution, arbitration, provides the settlement of the dispute by a third party – a person or an institution who should offer the required guarantees of neutrality and impartiality. Unlike in mediation, the decision is binding on the parties and publicly enforceable, and cannot be subjected to a second settlement under judicial procedures. Because of the combination of flexibility and enforceability, arbitration has proven to be very attractive for contract farming, although the method may occasionally be more costly. Because of its adjudicatory nature, arbitration must be recognised by the applicable law in order to be used. The arbitrator uses applicable law in its decision, but may also base its reasoning on principles of justice and fairness if the parties wish to do so and if it is recognised by law. The parties would do well to draft a definitive arbitration clause or a separate arbitration agreement in writing.

## **7.4. Judicial dispute resolution**

Finally, the parties can always decide to resort to judicial dispute resolution, unless the dispute has already been subjected to arbitration. Globally the procedures vary significantly depending on the particular legal system, but are often regulated under mandatory law with a high level of formality, ensuring the procedural guarantees for the litigants. Rules relating to the forum's jurisdiction can be seen as a part of such guarantees. As a way of protecting the weaker party, the forum might be imposed or the parties' choice in this respect might be otherwise limited. The main weaknesses of judicial dispute include the length of the proceedings and high costs associated.

After settling the dispute, enforcing the settlement or decision might still take a long period of time before the case is finally closed.

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