



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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**UNIDROIT Working Group
for the preparation of a Legal Guide
on Contract Farming**

First Meeting

Rome, 28 – 31 January 2013

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**Report on First Meeting of the UNIDROIT Working Group
for the preparation of a Legal Guide on Contract Farming**

Rome, 28 – 31 January 2013

(prepared by the UNIDROIT Secretariat)

1. The *UNIDROIT Working Group for the preparation of a Legal Guide on Contract Farming* – set up pursuant to a decision taken by the UNIDROIT Governing Council at its 91st session (Rome, 7-9 May 2012)¹ held its first meeting in Rome at the seat of UNIDROIT from 28 to 31 January 2013.
2. The Working Group was composed of the following members: Prof. Fabrizio Cafaggi (European University Institute, Italy); Mr Eduardo Alexandre Chiziane (Eduardo Mondlane University, Faculty of Law, Maputo, Mozambique); Prof. Marcel Fontaine (emeritus, Catholic University of Louvain Law School, Belgium); Prof. Henry Gabriel (Elon University School of Law, Greensboro, USA); Prof. Horacio Roitman (University of Cordoba Faculty of Law, Argentina); Prof. Paripurna P. Sugarda (University of Gadjah Mada Faculty of Law, Yogyakarta, Indonesia). Prof. Neil Hamilton (University of Arkansas School of Law, USA) was excused. The Food and Agriculture Organization (FAO) was associated as partner organisation while the following intergovernmental organisations were represented as observers: the International Fund for Agricultural Development (IFAD), the World Food Programme (WFP), the World Bank / International Finance Corporation. Observers attended in representation of the professional and trade interests, *i.e.* the World Farmers' Organization (WFO) and from one agribusiness company.²
3. The meeting was chaired by Prof. Henry Gabriel, member of the UNIDROIT Governing Council.
4. The Working Group used as a basis for its deliberations a document prepared by the UNIDROIT Secretariat: UNIDROIT 2012 – Study 80 A – Doc. 1 – *Preparation of a Legal Guide on Contract Farming – A preliminary outline of issues*. The documentation for the session included a number of Addenda documents providing information on selected issues³ as well as Working papers reproducing comments submitted by Working Group Members.⁴ With a view to facilitating the deliberations of the Working Group, the UNIDROIT Secretariat had set up an internal dedicated website providing access to material and resource references relating to the contract farming project.⁵

General background of the project

5. The UNIDROIT Secretary General provided brief background information on the mandate and working methods of UNIDROIT. He highlighted the expertise of the organisation in drafting modern private law rules for business transactions (and also non commercial relations) in varied areas such as secured financing for high value equipment acquisition, financial markets or general contract law. In the latter context, he mentioned the *UNIDROIT Principles of International Commercial Contracts* and the *Guide to International Master Franchise Agreements*. He indicated that the preparation by UNIDROIT of a legal Guide on contract farming provided the first opportunity for the organisation specifically to work in the agricultural field and contribute with its private law expertise to the objectives of international organisations committed to agricultural development and rural finance, in particular the United Nations Rome based agencies. He welcome the participation in the meeting of the representatives of multilateral organisations, in particular FAO and IFAD which had lent their support to the UNIDROIT project since initial consultations between the secretariats of the organisations.
6. From the outset, the UNIDROIT Secretariat has considered the involvement of the principal stakeholders vital in the development of a legal Guide on contract farming (*i.e.* agricultural producers and the buyers) so as to draft a legally and practically sound and useful instrument. The World

¹ UNIDROIT 2012 – C.D. (91) Misc. 3: Summary of the conclusions.

² See the list of participants reproduced in Appendix I to this report.

³ Add. 1 – Classification of pricing mechanisms and a review of price clauses; Add. 2 – Force majeure; Add. 3 – a Review under a US Perspective; Add. 4 – Overview of the “contrat d’intégration” under French law; Add. 5 – Certification in agricultural production; Add. 6 – An Overview of Contract Farming in Canada; Add. 7 – Providing Finance under Contract Farming

⁴ W.P. 1 – Comments by F. Cafaggi; W.P. 2 – Comments by M. Fontaine; W.P. 3 – Comments by A. Shepherd and C. Eaton.

⁵ www.UNIDROIT.org/contractfarming (username: farming – password: Study80a)

Farmers' Organization had expressed a keen interest in participating in the process. As regards the industry, one company had accepted to share its experience and be represented already in this first meeting, while a number of companies or agri-food associations declared that they would provide comments on drafts and participate in the Group meetings at a later stage of the work.

7. The Group agreed that the future Guide should aim at promoting contract farming as a source of profit for all parties involved, and that the participation of the private sector was essential for the success of the end product. Many companies applied good practices in their dealings with producers and their contract experience needed to be fully taken into consideration in the preparation of the Guide. From the firms' perspective, the future Guide could be seen as a useful instrument in providing a soft guidance and an internationally recognised reference with a fair and balanced approach, against which their contract practices could be assessed.

General approach to contract farming under the project

8. During the first day of the meeting, two presentations were made by FAO representatives: by Mr Carlos da Silva and Ms Carmen Bullon on "The importance and growing role of contract farming and the more critical issues"; and by Mr P. Liu on "The Impact of foreign investments in developing countries with particular attention to contract farming". Another presentation was made by Mr A. Shepherd of the Technical Centre for Agricultural and Rural Cooperation (CTA) on "Contract Farming from the perspective of the private sector".⁶ An exchange of views followed.

9. The Group took note of the economic approach to contract farming, a concept which describes a value chain management system aiming at higher efficiency through better coordination, lower costs and chain alignment over a potentially large number of stages (from production through processing, marketing until final consumption), involving exchange of goods, services and finance. Such systems operate relying on a variety of legal patterns linking the various participants who are often subject to common standards applicable to and influencing each segment of the chain.

10. While recognising the interconnection between the different segments of the chain, the Group agreed that the Guide should focus on the particular contractual relation between the producer and the buyer. In the context of the increased integration of the agri-food supply chains, this relation has original features and may present a fair level of legal complexity. Indeed, agricultural production contracts are characterised by the fact that parties undertake mutual obligations, typically a purchase commitment by the buyer and producer's commitment to deliver the produce in compliance with specific production requirements.

11. The Group reiterated that trust and mutual cooperation are crucial in building successful relationships and foster collaboration between the parties. It is important that contract farming agreements provide both parties the confidence that they both benefit from the relationship. Agreements must be balanced and not impose excessive burdens on one party only, particularly the weak party *i.e.* farmer/producer. However it was noted that companies also incur high risks and face cost constraints and that they have major interests at stake in the success of the relationship.

12. The Group noted that contract farming is a form of investment increasingly used and often supported by Governments, in particular through public private partnerships operations. Investors may have recourse to contract farming as an alternative to equity investment through land acquisition or lease, or may develop contract farming (in the form of outgrower schemes) around the plantations they control. By enabling farmers to keep control of the land, contract farming is an inclusive model of investment. Principles for Responsible Agricultural Investment ("RAI Principles") were being prepared within the Committee on World Food Security and the UNIDROIT initiative to prepare a legal Guide on contract farming could be seen as particularly timely in this regard.

⁶ The powerpoint presentations are available on the UNIDROIT dedicated Contract Farming internal website, *supra* note 5.

13. Preliminary views were exchanged within the Group regarding the kind of agreements that the Guide might cover and the particular aspects of such agreements that deserved special attention.

- spot market transactions and futures transactions are excluded from the kind of transaction covered by the Guide. Forward delivery contracts share common features with production contracts, in particular as regards risk allocation based on price determination. However production contracts generally involve a number of distinct features, such as the producer's obligation to comply with standards or the provision of inputs and technical assistance, training or technology transfer by the buyer.

- it was stressed that the concept of contract farming generally implies lasting relationships rather than one-off transactions. Contracts are generally concluded for fixed terms based on the biological cycle of the particular commodity, which could involve very short terms for production such as vegetables, to several years for tree crops, for example. Also, for many commodities typically produced under contract farming, contracts tend to be stipulated for a rather long period, taking also into account the amortisation of the equipment. The importance of a well structured and working price formula was stressed in building sound and long term relations.

- attention was drawn to the variety of parties that could be involved in a contract farming arrangement. In addressing the various aspects pertaining to the contract, the Guide should pay particular attention to the situation involving small holders in developing countries, many of whom are illiterate, suffer from tenure insecurity and have little or no access to credit. Providing clear drafting and explanations on contract terms, notably on how the price formula applies, is of great importance.

- it was emphasised that contract farming plays an important role in strengthening the financial capacity of the participants in the value chain, and it was considered that the Guide should illustrate the interplay between the production contract and the credit and finance (including microfinance) dimension.

- multiple transactions could take place around the production agreement, involving for example input suppliers, transport providers or other third parties providing services for the producer or the buyer, including certification – an increasingly important aspect of agri-food chains. Such transactions would be contemplated to the degree they may have an incidence over the contractual relations between producer and buyer. Other issues that could come up in the context of agricultural production such as possible third party liability, might need to be considered but only to the extent of their relevance in dealing with the production contract.

Envisaged addressees and outcome of the project

14. The UNIDROIT Secretary General indicated that, based on the preliminary enquiries of the Secretariat and the consultations with the interested multilateral organisations, the UNIDROIT Governing Council had contemplated the preparation of a guidance document which, similar to the *Guide to International Master Franchise Agreements*, would focus on the contractual relationship between the parties, i.e. producers and buyers, in contract farming transactions and would aim at informing and assisting parties in designing and implementing sound contracts. The Guide would be a soft law instrument not subject to negotiations by governments.

15. The Group agreed that the Guide would be primarily addressed to the parties – and more broadly to stakeholders in the contract farming relationship – for the purpose of providing them advice and guidance during the whole relationship, from negotiation to conclusion, from performance to breach or termination of the contract. The Guide would provide a description of common contract terms and a discussion of legal issues and critical problems that may arise under a variety of situations, it would illustrate how these may be treated or are regulated under different legal systems and certain types of legislations, and in so doing the Guide would promote a better understanding of the legal implications of contract terms and practices. When considered meaningful and under the

necessary flexible approach, analysis and discussion might lead to formulating contractual advice or recommendations. Under that perspective, the Guide would promote more stable and balanced relationships, help the parties develop good practices and generally contribute to building a sound and conducive environment for contract farming.

16. The Guide should not interfere with domestic compulsory rules nor should it intend to provide a model for, or encourage the adoption of, special legislation. As the Guide becomes increasingly influential, it could even diminish the need to legislate. It was suggested however that to the extent that the Guide would identify problems and highlight possible workable and fair solutions, it could also provide useful information for policy makers when considering the adoption of regulatory or legislative provisions dealing directly or indirectly with agricultural production contracts.

17. The Guide might have a variety of uses. It might be recognised as a reference for good practice by reflecting a minimum internationally accepted level of fairness in contract dealing. It was suggested that it could also be used by international organisations when asked by member countries to assist them by providing capacity building on the formulation of public governance instruments to sustain agricultural development. Also, the Guide might be useful as a basis to develop education tools in the context of training programmes addressed to farmers in some countries or sectors.

Types of transactions to be covered by the Guide

18. The Group agreed on the need to describe the kind of agreements that would be addressed by the Guide more specifically than the general concept of “contract farming” which referred to a system rather than to a particular type of transaction. It was suggested however that since the concept of “contract farming” was recognised almost as a label, it could be beneficial to keep this concept in the title of the Guide.

19. It was suggested to address the agreement as “agricultural production contract”, which would adequately capture the specific nature of the agreement. As a matter of clarity, the words “producer” and “contractor” should be used in order to indicate, respectively, the contractual party involved in the production and delivery of agricultural products, and the contractual party committed to purchase or take delivery of those products. The latter would typically be an agribusiness company engaged in food processing or manufacturing.

20. It was recognised that agreements may vary widely but that characteristic features could form a paradigm which would distinguish it from other contract types such as the traditional sale contract – a well known legal category. The paradigm pattern would allow for considering variants to reflect the multiple forms that may exist in practice.

21. It was felt that the definition elements should reflect a functional approach rather than being of a conceptual nature, and should focus on the objectives intended to be fulfilled by agricultural production contracts. This flexible approach would enable compatibility with the legal definitions that may be found under national legislations.

22. The characteristic features of the “agricultural production contract” covered by the Guide were preliminary considered to include: a legally binding agreement between a producer and a contractor for a fixed term, providing for the future production on a designated site of agricultural products to be delivered to the contractor, and whereby the production must be carried out according to the specifications of the contractor, for a price set in the agreement. The producer is an independent contractor rather than an employee of the contractor.

23. Agricultural production contracts must be for a fixed term, either one harvest or season or many production cycles, and may also be for long terms, depending on the kind of commodity.

24. The concept of “agricultural products” was intended generally to cover the production of a crop or the care and feeding of animals, but should be interpreted in a broad sense so as to include the many commodities that may be produced under contract farming for example aquaculture, livestock, forestry, fishery, etc.

25. The Guide should focus on contracts that are to be entered into before the production begins, thus distinguishing them from simple purchase contracts. The contract will specify the specific plot of land or site of production designated for the agreed production.

26. The producer's obligation is to produce under the specifications provided by the contractor. Specifications will refer not only to the output – with specified quality, quantity and time of delivery of the agreed produce – but also and typically the contractor will exercise a degree of control over the production process.

27. The concept of control by the contractor over the production was considered central in the type of contract under the Guide. This concept was discussed at some length within the Group. It was found that it could take a variety of forms :

- providing inputs, *e.g.* fertilisers, seeds etc., and/or
- providing services, *e.g.* soil preparation, harvesting etc., and/or
- providing financial support, *e.g.* advances, guarantees, etc.; and
- requiring that the goods be produced by means of a specific production procedure.

28. It was noted that the concept of control would not necessarily imply or require an economic subordination of the producer toward the contractor. Control should be intended in a legal and broad sense. It was thought that it could possibly include a variety of situations, such as partnerships and joint venture, as long as producer and contractor are separate entities with some sort of legal separation between them.

29. It was also indicated that a high degree of control by the contractor may lead to the conclusion, under the applicable legal system, that the producer worked under an employment relationship rather than under an agricultural production contract. Cases where the contractor owns the land or the infrastructure may lend greater merit to that conclusion. It was suggested that the Guide should limit itself to describe the different criteria used by domestic labour laws for identifying labor relationships and to emphasise that the more control the processor exercises, the greater the likelihood that the contract will be considered an employment relationship. The Guide would not deal with situations where the producer is an employee of the contractor, but only when the producer is substantially independent from the contractor.

30. The question was raised whether ownership of the land was relevant to defining the agricultural production contract under the Guide. It was recognised that under a typical contract farming arrangement, the land could be owned by the producer or simply used by the producer while the ownership vests with another entity, often the State. However, the situation where the contractor owns the land, as it may occur under certain contract farming arrangements, was seen as requiring further consideration. It was thought that it would not correspond to the paradigm contemplated by the Guide and might indeed raise a number of issues outside the scope of this work.

31. It was recognised that in agricultural production contracts, different situations may exist where either the producer or the contractor could be the owner of the goods produced (or could hold intellectual property rights over the inputs and/or the products). Although this aspect might be relevant under particular legislation and will have important consequences on many aspects of the contractual relation which will need to be discussed, title over the produce or inputs has not been found to constitute an essential element of the agricultural production contract under the Guide.

32. As to exclusivity, *i.e.* the commitment by the producer to sell all the produce from a designated area to the contractor, the Group observed that this was not to be considered an essential feature of production contracts since parties might agree that only a specified quantity of produce will be delivered under the contract, thus leaving the producer free to sell any extra quantity of goods produced from the land to other market participants. Nor were pricing mechanisms found by the Group to assume a distinctive nature for the purpose of characterising the type of agreement covered under the Guide.

33. The Group agreed to base its discussions on the following draft structure :

- Introduction
- Chapter I: Parties to the contract
- Chapter II: Contract form and contract formation
- Chapter III: Parties' obligations
- Chapter IV: Non performance and remedies
- Chapter V: Duration and renewal of the contract (including termination)
- Chapter VI: Applicable law
- Chapter VII: Dispute resolution

34. The question was raised whether, similar to the UNIDROIT Franchising Guide, the Guide might include an Annex, which would describe how different national legislations address contract farming.

35. It was suggested to include a general chapter supplemental to the introduction summarising the various chapters of the Guide. This chapter would also provide reference to general or basic principles relevant for the parties including: good faith, reasonableness, transparency, publicity, clarity Alternatively, the chapter may describe elements that should always be absent from the contract such as requirements that are not reasonable or necessary to protect a legitimate interest, using undue influence, pressure, unfair tactics, exploiting a much stronger bargaining position, non disclosure of critical information, unilateral changes of practices It was suggested that further thought should be given to which concepts should be covered and how they should be addressed.

36. It was suggested to include a comparative law glossary on how concepts used in the Guide could be translated in individual countries. However, it was said that while the Guide will address concepts and principles, it will not get into such a level of specificity.

Chapter I: Parties to the Contract

37. In this Chapter the Guide should describe various ways in which the parties to an agricultural production contract may organise themselves and the form they choose. It was suggested that cooperatives and other producer owned-entities deserve particular attention, one additional feature regarding such entities being the tendency to expand their activities from production into processing or manufacturing of finished / semi-finished products. The legal status of associations or other forms of farmer organisations producing collectively should be discussed, as well as the implications in particular with regard to the legal regime of production contracts under national law.

38. It was pointed out that public entities may participate in the contract as a contractor or in another capacity. This would have certain implications – e.g. as regards the possible relevance of special rules relating to public procurement – which would deserve consideration in the Guide.

39. Attention was given to the important role played by intermediaries in supply chains. It was noted the Guide would not cover a number of supply chain transactions that are generally understood to be included in the contract farming concept and where intermediaries are often involved. For example in South America a widespread figure is the intermediary known as "coyote" who acts simply and exclusively as a reseller with no incidence on the production process: there, the intermediary stands between producers and the company, with two separate sale and purchase relationships and no direct link between farmers and the company, thus not covered by the Guide. On the other hand, the Guide would consider the situations where the intermediary is a simple organiser acting on behalf of the company by providing technical assistance and inputs to farmers, and where a company acts on behalf of another company (the main contractor) and concludes a contract with the farmers taking care of the production and of the entire process. Here, the production contract links the company conducting the operations and the farmer.

40. It was generally accepted that if an agent is simply acting on behalf of another person, the latter would be considered as the party to the contract. However it was suggested that given the complexity of the legal treatment of intermediaries and their role in contract farming, further discussion should be deferred until a draft is available for further reflection.

41. The Guide should also address multi-party contracts and the relationship between these contracts and other linked contracts. In this context it was mentioned that the position of third party creditors may be relevant – for example a creditor who has obtained a secured position on the products grown on a piece of land for a certain number of years – and that it should be discussed in the Guide to the extent that it may have an effect on various aspects of the production contract.

42. As regards connected contracts, it was thought that alliances or partnerships between entities such as *contratto di consorzio* in Italy (for example), *pool de siembra* in Argentina, or other similar contractual agreements should probably be covered. Although some legal systems would see such forms as corporate entities, this would not be the case in other systems where the line between contractual and corporate agreements is not clear cut. It was recognised however that such situations would not correspond to the paradigm form that the project is intended to address.

Chapter II: Contract form and contract formation

43. It was stressed that production contracts (including even high value transactions) are often not stipulated in a single written document, but are concluded orally or through means such as e-mails, invoices, etc. depending also on local practices or trade usages. The Guide should refer to the great variety of forms that may be used in stipulating agricultural production contracts and should consider other forms of publicity or means (including by witness) that could prove the existence of the contract and its terms.

44. It was noted that in many countries where contract farming takes place, there is a high level of illiteracy. In the context of an enquiry made in OHADA countries with regard to a preliminary Uniform Act on Contract Law, this element was reported to have suggested two opposite approaches, some advocating a less formal approach to encourage flexibility and others advocating more formality to protect the weaker party. It was noted that often, Government facilitators or organisations provide assistance to farmers in their dealings with contractors, in particular when entering into the contract.

45. The Guide should discuss the interplay between contract content and domestic legislations, some of which may require written form and specific terms as a mandatory requisite. It was noted that in certain countries, contract farming operations may be subject to customary practices of local communities. It was noted that in a number of countries, customary rules are recognised as a source of law under the Constitution and it was recommended to examine the possible application of customary law in relation to contract form, but possibly also in relation with other aspects of the production contract where it may be relevant.

46. In general, it was suggested that the more complex the contract, the more advisable that it be in writing. This was stressed as useful not just to provide evidence of the contract but also to ensure that the parties are informed of their duties and obligations.

47. The Group pointed out that questions of validity of contract formation may be involved under the applicable law if one party were found not to have expressed a valid consent, because it was not aware of, or did not understand, the terms of the contract. This issue may arise in certain circumstances where one party is for example (a member of) a poor and illiterate community.

48. The importance of informational balance was pointed out. When entering into an agricultural production contract, producers should be aware of the potential implications and risks. It was felt that the Guide should advise on the desirable level of detail referring to the parties' obligations, and the merits of detailed provisions, as opposed to a rather general wording. A high level of specificity – for example in relation to the particular intended purpose of the inputs – was said to provide clearer information about the risks and, coupled with the preservation of evidence, to facilitate a proper

apportionment of liabilities in case of default. Another view was that contracts should be simple, not too long or specific, and should rather rely on the observance of trust and good faith by the parties, or similar general concepts and principles.

49. As regards the notions of fairness and reasonableness, it was recognised that they are not universal, and that contracts that would be enforced in a court in one country may instead be judged as unfair in other legal systems. However, there are common ground situations that could be seen as fundamentally unfair, and the Guide could describe how particular clauses would produce consequences that would be imbalanced or unreasonable. It was noted that some national legislations and specific laws on production contracts deal with unfair contract terms and that explanations provided in the Guide in this regard would be useful.

50. As regards contract documents, the Guide should consider both *ad hoc* contracts and standard contracts which are very often used by larger companies. Also it should discuss the importance of trade and regulatory standards which are very often incorporated in the contract by reference. Mention was made of language problems that may occur in this context, either because the documents referred to are in an unknown foreign language, or because they are overly complex and difficult to understand.

Chapter III: Parties' obligations

51. The discussions initially focussed on parties' obligations under the contractor's perspective. However, it was noted that the producer's obligations should logically be addressed before dealing with the contractor's obligations in the Guide. It was noted that the producer was to produce the agreed commodity in accordance with the contractor's specifications. One aspect to consider would be whether the producer is under a duty to deliver the whole production. When there is such obligation of exclusive delivery, a dependency situation would be likely to result, which should be discussed.

52. The Guide should recommend that the contract specify parties' obligations in a proper way. Detailed and precise contractual terms provide increased certainty regarding the content of the obligations, help foster compliance and avoid disputes and unfair practices.

53. In relation to the scope of parties' obligations under the contract, mention was made of implied terms that may be applicable (for example certain warranties or conditions would be required under national law to attach to certain categories of goods or commodities). It was noted that conditions that are imposed by the law and are not spelled out in the contract may not be fully appreciated by the parties – particularly the producer – and it was pointed out that such terms would likely to be alleged by a party – generally the contractor – as an excuse for not complying itself, unless the producer had included a warranty waiver in the contract. It was noted that the concept of implied terms in common law jurisdictions generally refer to the provisions of existing legislation, *i.e.* default rules applicable to the various aspects of the contract. In this context again it was mentioned that customary rules may be relevant.

54. It was suggested that in the context of Chapter III, attention should also be paid to trade usages as possible default rules. In considering trade usages it was pointed out that local practices may not be in line with global practices reflected for example in codes of conduct applicable to the whole value chain. For example the Roundtable on sustainable soy referred to agricultural practices and these were understood differently in South America and in Europe, reflecting different policy choices as regards impacts on environment and productivity. It was suggested that local practices would generally operate more in favour of farmers, the environment and the communities.

55. The discussions emphasised the correlation between the obligations of the parties: the contractor's obligation to deliver inputs or services and the producer's obligations to deliver the agreed produce. This has consequences for non performance and remedies. It was suggested that the price mechanism may capture this relation, for example by applying a penalty or a premium.

56. As regards inputs, the following considerations were made by the Group:

– It was noted that inputs supplied by contractors often give rise to litigation in relation with the production yield or with certain risks associated with the inputs (for example when the seeds are infected). So as to guarantee that inputs correspond to the specified quality, certification by an independent agency or other authorised entity (for example a Government body) is advisable. It was noted that fake inputs are becoming a major problem particularly in developing countries and it was suggested that the Guide should discuss this issue. Low quality inputs provided by contractors to influence the performance of the product (in the context of animal production) was also referred to in this context. Here again, the importance of good faith bargaining was stressed.

– Title (including intellectual property rights) over the seeds supplied by the contractor and whether this title would apply to the transformed goods – the crop – may be subject to different regimes depending on the particular jurisdiction: some would allow contractor to retain title or have some form of encumbrance over the crop or product while under others, the producer would be considered the owner of the product. This has consequences for example for the purpose of determining whether the producer is entitled to use the crop as collateral, whether it would incur third party liability from dissemination of material protected by intellectual property, or whether it would not be entitled to generate and use seeds from the produce. This particular aspect has major consequences with regard to farmers' practice to save seeds and use them for future planting. It was generally felt that the Guide should not encourage this particular practice, and could perhaps mention that there are different ways to protect intellectual property rights over seeds and plants. Thought was also given to whether similar issues of title retention could apply regarding inputs other than seeds. It was agreed that the Guide should consider these issues, and discuss the various options and their possible implications.

57. As regards services, the following considerations were made by the Group:

– It was observed that a wide range of services can be provided. One particularly important kind of service is the technical management of production with instructions regarding methods to be followed in the production process or oversight provided by the contractor. Both of these, it was mentioned, could produce certain responsibilities. In other instances, the contractor will perform directly or have the service performed by a third party. In this context, the situation was reported of an accepted practice in seed production regarding cross pollination. This is a delicate operation that could be carried out either by producers, in which case producers would be responsible for the quality, or by the company or under the company's supervision. In the latter case, the contractor would not hold producers liable for quality issues and would buy all the production. This allocation of responsibility is reflected in the contract.

– It was agreed that the Guide should discuss the interplay between confidentiality of the contract and intellectual property rights. Imposing a duty of non disclosure of the contract on farmers may work to their detriment as this substantially prevents them from asking for technical or legal assistance. On the other hand, it was legitimate for contractors to retain confidential information such as trade secrets relating to the technical assistance provided. It was suggested that special attention should be provided to the issue of whether property rights can be derived from confidentiality, when such rights are not specified in the contract.

58. It was suggested that the Guide should consider the situation where inputs and services are discounted from later payments, as well as the price charged for such inputs and services vis-à-vis the market price. It was agreed that this issue was relevant also in considering the balance of parties obligations and risks, and was closely connected with regards pricing mechanisms.

59. With respect to the delivery of the goods, many aspects are involved which can potentially give rise to conflicts. It was suggested that the Guide should focus on the major issues. One such issue concerned typically the evaluation of the quality and quantity of the goods. Attention should be given in this context to the issue of fraud, such as manipulating of either the weight of the produce or the elevator. The likelihood of fraud would be reduced with the participation of both parties in the delivery

operation or with the intervention of an independent third party, which could be described as good practice. Another relevant issue include logistics and transport – *e.g.* which party is to collect the produce, to pay for the freight, what consequences attach to non compliance with instructions regarding the timing of operations. Other operations such as labelling, packaging or other delivery preparations may be involved.

60. An issue which was considered crucial to discuss in the Guide was the relation between delivery and title transfer.

61. As regards price and pricing formula, the following considerations were made by the Group:

- There are many possible price mechanisms. Price mechanisms reflect a whole range of elements related to the obligations and risks undertaken by the parties, and would include inputs and services provided by the buyer. It was noted that the price is correlated with the length of the production cycle, which in turn depends on the nature of the commodity: for long term contracts the price is generally based on market price at the time of sale so the risk is shared by both parties.

- Under a common formula, the producer receives a base-price plus a flexible share often linked to market price at the time of delivery, subject to price volatility which can be high. It was mentioned that certain production contracts for export markets include a flexible parameter based on the exchange rate between export and import countries, which was an added factor of volatility. It was noted that, in some countries, prices may be subject to State regulation (with either minimum or maximum prices). Mention was made of the practice of adjusting the price over the length of the contract based on key performance indicators.

- It was observed that price and payment conditions are often imposed by the contractor, rather than negotiated between the producer and the contractor. This is often the case if competition between buyers is low, which can lead to contract imbalance and unfairness. This aspect would be particularly relevant in countries where competition law is not sufficiently robust to correct these negative effects. While the Guide is not intended to deal with competition law, it could illustrate how, depending on a particular market structure, contract farming may lead to a level of concentration which could determine anti-competitive results to the detriment of farmers.

- The price may include very complex parameters based on performance (an example being the poultry production) with incentives provided to farmers. It was suggested that the Guide should promote good practices by encouraging balance between contract competitiveness and environmental exploitation, emphasising the importance of improving the quality of the product and its impact on the environment, rather than focusing only on increasing the quantity. This would also serve to illustrate the role of incentives in applying certain standards of diligence in the production process. Since diligence in the production process entails higher costs for farmers (for example respecting hygiene rules in the milking operation), the price should provide adequate remuneration to the farmer. The economic and policy implications may also factor into the remuneration, since the process is likely to result in higher quality milk and provide beneficial effects on the surrounding environment. It was noted that incentives can promote competition among farmers, which may also have some detrimental effects. Mention was made of "tournament" compensation programs widely used in the poultry industry which base compensation of one contract producer on the performance of other producers: such programs are seen as potentially allowing contractors to unfairly discriminate against producers and are not allowed under certain legal systems.

- Often the contract does not contain an adequate basis for calculating the product price. At times, the price is not set in the contract but at a later time. The Guide should emphasise that whatever the pricing mechanism, it must be transparent, clearly set and understood at the beginning of the production.

- Producer's high vulnerability to price volatility at the time of sale, produces side-selling. It was also noted that volatility may also concern the price of inputs over the length of the contract between the time they are delivered for production, and the time they are discounted from the final payment.

– Good practices were mentioned whereby the contract could include a clause for renegotiating the price when legitimate commercial reasons occur.

– It was noted that scaling systems, sometimes included in price clauses, might serve to circumvent laws applicable to penalty clauses. This may be true in jurisdictions where local law would not allow penalty clauses or the judge would be authorised to reduce a compensation amount which is considered to be excessive. The Guide should discuss this aspect.

62. The Guide should discuss time payment terms, and possible effects.

– It is usual that payment be made after delivery – usually between 30 to 90 days. This entails risks incurred by farmers regarding the financial ability of contractor to pay. The Guide should discuss the mechanisms that may exist to protect the producer: some States provide for a lien against the buyer, others provide guarantee funds through State banking schemes, insurance schemes and/or payment guarantees. This issue should be discussed also in relation with the time of ownership transfer. Also, long payment terms entail added costs for the producer who may need to have recourse to receivable financing when possible, or support inflation losses. Depending on the circumstances, these costs may be significant. Also regarding payment conditions, full transparency was advocated in the contract, with possible corrective mechanisms (for example against currency devaluation).

– Payment may also occur upon delivery. It was reported for example that certain IFAD financed programmes were testing a “Cash-on-the-Bag” model, which is based on cash payment upon delivery. This model attempts to improve transaction environment for smallholders in markets where persistent default by producers and low prices are common, by promoting more secure and transparent transactions.

63. As regards specifications, the following considerations were made by the Group:

– Specifications may refer to the product or to the process. Clear contractual terms regarding specifications are recommended so that parties’ expectations and obligations are clear. Special attention was drawn upon designations (such as acronyms frequently referring to standards) that the producer may not understand. Also the importance of producer keeping record or documenting compliance was emphasised to testify that specifications have been complied with, not only as regards the buyer, but for traceability and product safety purposes.

– Attention was drawn again in this context to standards expressly referred to in the contract, incorporated by reference, or which may derive from implied terms. Also, and to the extent that this may be relevant under the Guide, the vertical interdependence along the supply chain might be worth considering in the contract. This interdependence would refer to traceability requirements (and documenting the various operations and components of the goods) and might also involve the possible effects of non compliance at one stage of the supply chain over the other levels of the chain.

– As a way to establish compliance with specifications, the role of third parties was said to be of great importance. When parties disagree on the quality of the produce, expertise may be provided by technical bodies at delivery location, or by other independent and neutral entities (rather than *e.g.* contractor’s laboratory). Mention was also made of public bodies or government entities acting as facilitators, which may assist the parties at the time of delivery.

– Certification was emphasised as being of great significance, as a means for the buyer to exercise control over the production. It was noted that different certification and other verification/evaluation methods exist – those that apply to a product, to a process or to the chain of custody as a whole. Certification may also be conducted by different participants. It was suggested that the Guide should examine who is responsible for obtaining certification when required and should examine self certification by producers. It was also suggested that producer organisations (including cooperatives, associations etc.) or communities play a role in this regard, particularly taking into account the potential costs involved. Other related issues to be discussed would involve the ownership of the certification, which could also have consequences over competition between market

participants. As a result of these considerations, it was suggested that certification might be dealt with in a specific section of the Guide.

Chapter IV: Non performance and remedies

64. In the context of non performance and remedies, reference was made again to the correlation between the obligations of the parties. It was noted that detailed terms in the contract would bring certainty as regards the levels of non performance that would trigger different possible remedies, for example by indicating what would amount to substantial or material breach.

65. In particular, it was felt that the Guide should discuss the extent to which a breach by one party might entitle the other party to withhold performance, and the extent to which the party not in breach will have a duty to mitigate the loss caused by non performance. It was observed that mitigation of damage was not recognised as a duty in every legal system, and that it would be advisable that parties include a provision to that effect in the contract.

66. It was observed that mitigation would vary depending on the particular nature of the commodity produced. In particular, the ability to mitigate loss in the context of quality requirements would often be correlated to the existence of secondary markets, and parties would be inclined to reach an agreement when there are second-best options. If there are no secondary markets (for example when products are subject to intellectual property rights requiring that non-complying goods be destroyed), the Guide may recommend price mechanisms that internalise this risk.

67. The complexity of determining the cause of non-performance was also considered. Many elements may have an effect on the end product (not the least of which are natural factors). As a result, causation may be very difficult to establish. The apportionment of liabilities was said to be very much a question of circumstances and proof. The importance was stressed in this context of keeping precise documentation and record of the various operations performed during the production process. Evidence will be all the more important when price volatility increases, as parties attempt to escape performance.

68. When it is not possible to determine with reasonable certainty which party is in breach of contract, a fair arrangement might be that both parties should share the loss. It was also pointed out that many circumstances were beyond the control of the parties, even when they are not *force majeure* events, and posed a problem for the allocation of risks.

69. When it is difficult to identify causal factors for a breach, it was suggested that the contract attempt to provide for a correlation between default and price. This could be the case for example in pricing scales that account for variation in the quality of produce.

70. It was suggested to address insurance issues. It was observed that insurance is generally available against all kinds of risks. The producer and the contractor should agree which party is in the best position to take out insurance and which should bear the cost.

71. As regards contractor's breach and remedies available to producer, the following considerations were made by the Group:

- Frequently reported breaches relate to inputs. Non delivery and late delivery of inputs may cause major loss to producer (e.g. the producer may have incurred significant expenses in soil preparation, may have contracted interest-bearing credit, may obtain lower production for late planting, and/or may be exposed to changes in market conditions).

- The Guide should discuss the remedies available to the producer when he does not produce the expected goods as a result of contractor's delivery of inappropriate inputs, and the differences in opting for liability remedies or for invalidity remedies (entailing restitution, for instance).

- It was observed that in certain occasions where the contractor has delivered defective inputs or defective services, the producer would rather use them, than reject them, so as to mitigate

the loss (e.g. using defective feed not to have the animals die). To what extent the contractor could be entitled to claim that the producer had indeed accepted the inputs or services should be discussed.

– It was suggested that the Guide should explore the relationship between delay in the delivery of inputs and price determination. In this respect it has been preliminarily observed that the delay in providing inputs may well affect the price. It was suggested, then, that the contract may link delay to price, so that delay would make the price higher; such a clause would reduce the amount of litigation.

72. As regards producer's breach and remedies available to contractor, the following considerations were made by the Group:

– Conditions for rejecting non conforming goods should be discussed in the Guide. Contracts may provide for different grades of quality, or may provide that non conforming goods would be rejected outright.

– A common breach relates to late delivery of the produce. Consequences are closely related to the type of commodity – whether perishable or non-perishable. Usually, when the producer is late in delivering the goods the contractor downgrades the product and pays a lower price than the one agreed.

– It was suggested that in discussing the remedies available to contractor, the Guide should consider the correlation between remedies under the law generally based upon the differentiation between material and non material breach, and remedies under the certification scheme which often provide for a sophisticated scale of sanctions. It was suggested that in the case of long-term relationships, parties should be encouraged to cure the breach and to provide for a range of remedies up to the point of breach of contract.

– It was considered whether curing non performance would be applicable in the context of production contracts. It was noted that the right to cure non performance may not be available in cases of material breach which would entail termination. It was also suggested that it would depend on whether the defect concerns the product attributes or the production process. For example when production is required to be organic, curing non delivery with other goods which have been produced under different conditions would not be acceptable by the contractor. Mechanisms allowing to cure a breach of contract are frequently applied, such as downgrading the quality of the goods and reducing the price. It was noted that this should be recommended when because of natural events or seasonality, the product does not meet the agreed specifications. It was suggested that Article 7.1.4 of the *UNIDROIT Principles of International Commercial Contracts* and the commentary thereon could provide a useful reference.

– As regards specific performance, it was noted that it may not be applicable in every jurisdiction, and that damages would probably be the most common remedy. It was noted that specific performance would likely to be claimed rather when high value / non standardised commodities are involved, typically to avoid side selling by the producer. An example provided described a producer association which was required to remove trees subject to contractor's intellectual property rights from the farmland, as a result of non compliance with production guidelines.

– Another common breach by producers was reported to relate to deviation of inputs, or selling the product outside the contract – so-called "side-selling". Side-selling is likely to occur when market conditions would ensure higher price for the producer, regardless of the implications on the relationship, generally the termination of the contract. Different levels of damage may result for the contractor depending on the circumstances, including the loss of the intellectual property rights when protected goods are involved. It was suggested that the Guide should illustrate the implications, including how this practice works to the detriment of the producers themselves. It was suggested that side-selling may be less likely to occur when, under the contract type used, the producer is not the owner of the produce. It was also observed that in some countries the legal system makes it

unlawful for buyers to buy from people who are engaged in contracts with others. It was suggested to consider how to address this practice, one possible approach being to allow for some flexibility in the contract so as to take into account changing market conditions.

73. As regards *force majeure*, it was noted contract clauses are extremely important and should be carefully drafted. The Guide should have a broad approach covering a large number of events that are not under the control of the parties and which may affect contract performance. Usually clauses contain a list or a general description of what constitutes *force majeure*, some kind of notification requirements and the consequences of *force majeure* events. The Guide should illustrate how to draft *force majeure* clauses depending on the applicable law and on the specific risks of the context in which the contract is to be performed. It was suggested that the Guide may discuss this issue by providing examples.

74. The question was raised whether a very high price volatility or a dramatic change in economic circumstances may be treated as *force majeure* events, or otherwise providing a ground for remedy, for example for economic hardship. The general view was that this would not be the case, price volatility being generally considered as a risk internalised in the contract which is usually dealt with by the pricing mechanism.

75. As regards termination for breach, it was noted that in virtually all cases the party entitled to terminate the contract is the contractor. It was reported that clauses vary a lot, sometimes they are short and simple, sometimes they are long and complex. Termination occurs when parties cannot reach an agreement to continue with the execution of the contract, for example by renegotiating the contract in case of goods non complying with specific quality standards. Termination clauses are sometimes included entitling one party (typically the contractor) to unilaterally terminate the contract, at will. This may happen for example when downstream buyers cancel their orders. This type of clause should be carefully analysed in the Guide, as well as the consequences of termination upon financial commitments undertaken by the producer.

Chapter VI: Duration and renewal of the contract

76. The Guide should recommend that contracts describe the term of duration. It was suggested that two elements are particularly relevant to set a proper duration: (i) the length of the biological cycle of the goods; (ii) the financial obligations made by the parties. In this latter case, considerations should include the time needed by the producer to amortise the investment in equipment and installations for the production or needed to repay financial obligations contracted with credit institutions.

77. It was noted that contracts often contain consensual termination clauses allowing the parties to end the contract – especially long term contracts – upon prior notice and within a stipulated time. It was noted that frequently parties do not enjoy the same rights in this regard, and in certain occasions one party is entitled to unilaterally terminate the contract, at will.

78. It was emphasised again in the context of the duration of the contract that the virtues of contract farming for both parties would derive from stable contractual relationships so that the individual contract could be seen as a part of an overall contract flow, characterising it as a “relational contract”. It was noted that the costs of entering into a relationship are generally spread out over several seasons and that the continuity of the relationship may have implications on the individual contract (such as the relevance of practices and previous dealings) which should be further explored.

79. It was noted that certain contractual obligations may survive termination: right to payment for performance delivered for instance or the duty not to disclose confidential information about technologies and the production process. Mention was also made of certain obligations which may be linked with goods subject to intellectual property rights, whereby the producer may be obligated to destroy or get rid of the seeds or goods.

Chapter VII: Applicable law

80. It was observed that the vast majority of agricultural production contracts would be domestic contracts, governed by domestic law. Most multinational corporations engaged in contract farming transactions generally act through local traders or agents who would themselves enter into production contracts with producers. It was suggested that producers would generally expect their domestic law to apply, and if it were not the case, some clear explanation should be provided.

81. It was pointed out that when the product is to be exported, a foreign law may be found relevant as regards certain aspects of production contracts – for example quality and safety standards. It was suggested that contracts entailing exportation of goods may require a particular attention with respect to applicable law issues that parties should be aware of.

82. When the contract itself is international, parties may be entitled to choose a particular law to apply to the contract (for example, reference was made to the widespread practice of designating British law to apply to commodity export contracts). The Guide should also discuss the applicable law in the absence of parties' choice. In this regard it was suggested that the application of the law of the buyer – commonly designated under conflict-of-law rules applicable to a sale contract – would generally be in the buyer rather than the producer's interest. The Guide should discuss the possible solutions under a conflict of law approach.

83. It was also suggested that the Guide might discuss the possibility for the parties to refer to the UNIDROIT Principles in the context of an international contract, and discuss also their possible relevance as regards purely domestic contracts.

Chapter VIII: Dispute resolution

84. It was noted that disputes very rarely end up in courts because of the high costs and long procedures generally involved. In certain contexts, corruption of judges is reported to be a problem.

85. Alternative dispute resolution mechanisms are generally seen to offer more adequate solutions to parties. However, it was observed that recourse to arbitration may also involve costs which are beyond the limited financial capability of producers, while the law on arbitration may not be adequate or adequately applied. Also, it was noted that the impartiality of arbitrators may not always be guaranteed, especially when the arbitration clause is inserted at contractor's initiative (for example in a standard contract) and designates an arbitration board or trade association which represents the industry's interests. For this reason, certain jurisdictions did not allow parties to provide for compulsory recourse to arbitration.

86. Negotiation between the parties is generally advocated as the most appropriate way of overcoming disputes and allowing for the continuation of the contract. Mediation mechanisms are often organised by public authorities or commodity boards and may be compulsory under specific legislation. In this context, mention was made again of quality expert institutions that can intervene quickly to settle disputes regarding the attributes of the delivered product.

87. It was agreed that the Guide should discuss the various forms of dispute resolution systems and the implications for parties to have recourse to them in the context of agricultural production contracts.

Future work

88. The Group agreed that a second meeting will be held on 3-6 June 2013 when the first drafts prepared by the Secretariat (Introduction and Chapter I) and Prof. Gabriel and Prof. Fontaine as rapporteurs (Chapter III) will be discussed. A third meeting will be held on 18-21 November and a fourth meeting in April 2014 (dates to be confirmed).

UNIDROIT Working Group for the preparation of a Legal Guide on Contract Farming

First Meeting – Rome, 28 – 31 January 2013

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