

International Institute for the Unification of Private Law – UNIDROIT

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UNIDROIT/FAO/IFAD

Legal Guide on Contract Farming

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FOREWORD

Contract farming, broadly understood as agricultural production and marketing carried out under a previous agreement between producers and their buyers, supports the production of a wide range of agricultural commodities and its use is growing in many countries.

Contract farming helps increase agricultural productivity, improve the livelihood of the rural poor, and may play a role in preventing rural exodus. These and other potential economic and social benefits explain the interest of many domestic policy makers and international organizations in promoting sustainable contract farming models as part of their efforts to achieve food security.

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 this UNIDROIT/FAO/IFAD Legal Guide on Contract Farming.

The Guide is the product of a Working Group set up by UNIDROIT, which brought together internationally-recognised legal scholars, partner multilateral organisations and representatives from the farming community and agribusiness. Stakeholder representatives, international civil servants, practising lawyers and academics from different backgrounds and legal cultures 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 process of development, the UNIDROIT Governing Council considered and adopted the Guide at its 94th session, held in May 2015.

The UNIDROIT/FAO/IFAD Legal Guide on Contract Farming is aligned with the Principles for Responsible Investments in Agriculture and Food Systems (RAI Principles) approved in October 2014 by the Committee on World Food Security. The Guide also shares with the RAI Principles the goal of providing a framework that stakeholders can use when developing domestic policies,

regulatory frameworks, corporate social responsibility programmes, individual agreements and contracts, all of which in responsible and inclusive ways.

We place on record our deep gratitude to the members of the Working Group for their hard work, enthusiasm and dedication. We also wish to thank all those who submitted comments, made suggestions and otherwise contributed at various stages of development of this text.

We are confident that the Guide will be a useful tool and reference point for a broad range of users involved in contract farming practice, policy design, legal research and capacity building. We hope that the Guide will contribute to creating a favourable, equitable and sustainable environment for contract farming.

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CONTENTS

Foreword	v
Members of the Working Group	vii
PREFACE	xix
I. Overview and purpose	xix
II. Approach and how to use the Guide	xx
INTRODUCTION	1
I. General introduction to contract farming	1
A. Various contract farming operations in practice	2
B. Benefits and risks of contract farming	6
1. Risk mitigation	7
2. Access to credit	10
3. Technology and know-how transfer	11
4. Economic, social and environmental development	12
II. Scope of the Guide	13
A. The agricultural production contract under the Guide	14
B. The contractor's involvement in production	14
C. Distinguishing agricultural production contracts from partnership and employment relationships	16
1. Agricultural production contract versus partnership	16
2. Agricultural production contract versus employment	16
CHAPTER 1 – THE LEGAL FRAMEWORK	19
I. The applicable private law regime	19
A. Legal treatment of agricultural production contracts	20
1. Special category of contract	21
2. Traditional contract types	23
B. Other domestic legal sources	25
1. Rules and principles of law	25
2. Customary rules and usages	27
3. Trade usages and practices	28
4. Standard terms and guidance documents	28
(a) Standard contract terms and contractual documents	28

(b) Technical standards	29
C. Contracts with an international element	31
1. Contractual obligations	31
2. Non-contractual obligations	33
II. The role of the regulatory environment	33
A. Agri-food trade	34
B. Production inputs	36
1. Seeds	37
2. Biosafety	37
3. Plant Variety Protection	37
4. Producers' right to genetic resources	38
5. Other agricultural inputs	39
C. Agricultural finance and support	39
D. Competition and antitrust	39
E. Human rights	40
F. Labour law	41
G. Access to natural resources	42
CHAPTER 2 – PARTIES, FORMATION AND FORM	44
I. Parties to the Contract	44
A. The agricultural producer	45
1. Distinctive features	45
2. Legal status	46
3. Forms for conducting an agricultural production activity	47
(a) Individual producers	47
(b) Producer organisations	49
B. The contractor	54
1. Private corporate structures	55
2. Public entities	56
C. Other parties	57
1. Supply chain participants	57
(a) Linkages between participants	58
(b) Types of participants	59
2. Other interested third parties	62
II. Contract formation	62
A. Offer and acceptance	63
B. Capacity and consent	67
C. Role of those who intervene or assist in contract negotiation	70
1. Producer organisations	71
2. Facilitators	71
3. Public authorities	71

4. Intermediaries	72
III. Contract form and content	73
A. Contract form	73
B. Contract content	75
C. Consequences of breach of required form or content	80
CHAPTER 3 – OBLIGATIONS OF THE PARTIES	82
I. Risk allocation	83
A. Production risk allocation	84
B. Commercial risk allocation	86
C. Exclusivity	87
II. Core obligations of the parties	89
A. The product	89
1. Quantity	89
(a) The whole production is purchased	89
(b) Only part of the production is purchased	91
2. Quality	94
(a) Determining quality	95
(b) Quality standards	96
(c) Product safety	99
(d) Link with certification requirements	100
B. Production process	101
1. Provision and use of inputs	101
(a) General obligations	101
(b) Specific obligations related to certain types of inputs	104
(c) Obligations related to intellectual property rights	111
2. Production methods, compliance and control	114
(a) Specified production methods	115
(b) Monitoring and control	119
C. Delivery	121
1. Time and place	122
2. Acceptance	124
D. Price and payment	127
1. Price determination	127
2. Price mechanisms	128
(a) Fixed prices	129
(b) Price scales	130
3. Time and method of payment	131
III. Additional obligations	133
A. Insurance obligations	133
B. Record keeping and information management	134

C. Community interests	135
IV. Transfer of obligations	136
CHAPTER 4 – EXCUSES FOR NON-PERFORMANCE	137
I. Force majeure and change of circumstances in agricultural production contracts	137
A. Supervening events affecting the performance of the parties	137
B. Force majeure versus change of circumstances	138
C. Contractual allocation of risks through force majeure clauses	140
D. Risk allocation and title transfer	141
E. Insurance and other risk mitigation and allocation schemes	142
II. Events qualifying as force majeure and change of circumstances	143
A. General notion of force majeure in contractual practice	143
1. Natural events (“Acts of God”)	144
2. Governmental acts	145
3. Other disturbances: strikes, wars, social unrest, and market disruptions	146
B. Relevant change of circumstances in contractual practice	146
C. Burden of proof	147
III. Consequences of the recognition of force majeure and change of circumstances	148
A. Effects on the parties’ obligations	148
1. Excuse from non-performance	148
2. Suspension of performance	149
3. Compensation and indemnities	150
4. Additional obligations: notice and mitigation requirements	150
B. Effects on the contract as a whole	152
1. Termination of the contract	152
2. Right or duty to renegotiate	153
3. Judicial adaptation	154
CHAPTER 5 – REMEDIES FOR BREACH	155
I. Overview of remedies	155
A. Different types of remedies	158
1. Remedies in kind	160
2. Withholding performance	161
3. Price reduction	162
4. Termination	163
5. Restitution	165
6. Damages	167
7. Interest and late payments	170

B. The role of the aggrieved party's conduct	171
C. The breaching party's right to cure	172
D. Renegotiation	173
II. Contractor's remedies for producer's breach	173
A. Remedies in kind	175
1. Breach of process-related obligations	175
(a) Right to performance	176
(b) Corrective actions	176
2. Product non-conformity	177
(a) Corrective measures	179
(b) Repair	181
(c) Replacement	181
3. Failure to deliver the product	182
B. Product withdrawal and product recall	183
C. Withholding performance	184
D. Price reduction	185
E. Termination	186
1. Breach of process-related obligations	187
2. Product non-conformity	187
3. Failure to deliver the product	187
F. Damages	188
1. Breach of process-related obligations	188
2. Product non-conformity	189
3. Failure to deliver the product	191
G. Penalties, fines and blacklists	191
H. Contractor's conduct and claims for remedies	192
III. Producer's remedies for contractor's breach	195
A. Right to performance	195
1. Delay in price payment	195
2. Failure to provide (conforming) inputs	196
3. Failure to take delivery of conforming goods	198
B. Withholding performance	199
C. Termination	200
1. Failure to pay	201
2. Failure to provide (conforming) inputs	203
3. Failure to take delivery of conforming goods	203
4. Failure to purchase the whole production (or a percentage of it)	203
D. Damages	204
1. Delay in payment	204
2. Failure to provide (conforming) inputs	205
3. Failure to take delivery of conforming goods	205

4. Liquidated damages and penalty clauses	206
E. Producer's conduct and claims for remedies	207
CHAPTER 6 – DURATION, RENEWAL AND TERMINATION	210
I. Duration	210
A. "Short-term" contracts versus "long-term" contracts	211
B. Maximum and minimum duration imposed by law	212
II. Renewal of contracts	212
A. Renewal by express agreement	212
B. Tacit or automatic renewal	213
C. Renewal at the option of one party	214
III. Termination	215
A. Scope	215
B. Termination clauses	215
C. Notice requirement for termination	216
D. Grounds for termination	216
1. Automatic termination	217
2. Consensual termination	217
3. Termination by one of the parties in accordance with special termination clauses	217
(a) Clauses providing for termination by either party	217
(b) Clauses providing for termination by one party	218
(c) Termination for loss of trust	219
E. Effects and consequences of termination	220
CHAPTER 7 – DISPUTE RESOLUTION	221
I. Disputes and dispute resolution in agricultural production contracts	222
A. Addressing disputes in agricultural production contracts	222
1. The importance of addressing dispute resolution in the contract	222
2. Preventing disputes through negotiations and cooperation	223
3. Parties' access to a fair and effective dispute resolution method	223
B. Considerations regarding the various dispute resolution methods available for the parties	224
1. Nature of the dispute, time factor, interim relief	225
2. Fairness, confidentiality	225
II. Non-judicial dispute resolution methods	226
A. Common features	226
B. Mediation and conciliation mechanisms	228
1. Alternative amicable dispute resolution methods	228
2. Benefits of mediation	229
3. Organising mediation proceedings	230

(a) Mediation clauses	230
(b) Institutional versus ad hoc mediation	230
(c) Elements of mediation proceedings	231
(d) Outcome of mediation proceedings	232
C. Arbitration	232
1. A binding (adjudicatory) dispute resolution	232
2. Organising arbitration proceedings	233
(a) Arbitration agreements	233
(b) Institutional v. ad hoc arbitration	234
(c) Procedural guarantees	234
(d) Arbitration and interim relief	235
(e) Outcome of arbitration proceedings	236
III. Judicial dispute resolution	236
A. Access to justice	236
B. Jurisdiction grounds	237
1. Domestic contracts	237
2. International contracts	238
IV. Enforcement of settlements or decisions resolving a dispute	238

PREFACE

I. Overview and purpose

1. The *UNIDROIT/FAO/IFAD Legal Guide on Contract Farming* is primarily addressed to the parties to a contract farming relationship, *i.e.* producers and contractors. It provides advice and guidance on the entire relationship, from negotiation to conclusion, including performance and possible breach or termination of the contract. The Guide provides a description of common contract terms and a discussion of legal issues and critical problems that may arise under various practical situations, illustrating how they may be treated under different legal systems. In so doing, the Guide aims to promote a better understanding of the legal implications of contract terms and practices. It intends to promote more stable and balanced relationships and to assist parties in designing and implementing sound contracts, thereby generally contributing to building a conducive environment for contract farming. While the Guide does not intend to promote one form of contract over others, it can serve as key reference material for parties assessing their legal position and the options available to them during contract negotiations and performance, thereby securing their position in the supply chain, and helping to maximise their negotiating position in financial and economic terms.

2. The 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 considering the adoption of regulatory or legislative provisions dealing directly or indirectly with agricultural production contracts. The Guide could be recognised as a reference for good practice by reflecting a minimum internationally accepted standard of practice in contract dealing.

3. The Guide intends to provide practical guidance to international organisations and bilateral cooperation agencies, as well as non-Governmental organisations and farmers' organisations, engaged in

strategies and capacity building programmes in support of contract farming, especially in developing countries. The Guide could also be useful for professional organisations, judges, arbitrators, legislators, and perhaps even most importantly, for mediators, because it promotes cooperative dispute resolution. In addition, the Guide should be useful as a basis for developing educational tools in the context of training programmes addressed to producers in specific countries or sectors. Investing in agriculture and food systems can produce multiplier effects for complementary sectors (such as the service or manufacturing industries), thus further contributing to food security and nutrition, and overall economic development. The Guide is therefore not only seen as a development tool assisting small producers but it may also be a catalyst in improving the socioeconomics of rural, agricultural communities. Although primarily focused on legal considerations in the negotiation of agricultural production contracts, the Guide also lays the groundwork for the consideration of policy aspects, particularly in the broader areas of agricultural investment and micro-financing.

II. Approach and how to use the Guide

4. The Guide recognises that contract farming may be seen under an economic approach as describing a supply chain management system which potentially includes several stages, from production through processing and marketing to final consumption. Contract farming, as a system, involves an exchange of goods, services and finance, and aims at higher efficiency through better coordination, lower costs and chain alignment. Systems rely on various legal patterns linking the several participants who are often subject to common standards applicable to and influencing each segment of the chain.

5. The Guide deals with a wide range of agricultural production contracts, from straightforward transactions between a contractor and an individual producer or group of producers to more complex transactions with direct or indirect involvement of third parties, such as government agencies, development aid and certifications schemes. Comments that assume a certain level of complexity should not be understood as a suggestion that this is the norm for all agricultural production contracts.

6. Moreover, the Guide focuses on the particular bilateral relationship between the agricultural producer and the contractor seeking to obtain a designated product, based on an “agricultural production contract.” Under such a contract, the producer undertakes to produce and deliver

agricultural commodities in accordance with the contractor's specifications. 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. Other parties may participate in the production contract itself, and insofar as the internal obligations and remedies of the producer and the contractor may be affected, multilateral contracts or bilateral contracts built around the main relationship will be considered. While recognising the interconnection between the different chain segments, a global supply chain legal analysis is, however, beyond the Guide's scope.

7. The legal discussion and analysis presented in the Guide build upon a concrete approach based on references to practical operations and contract practices. Mandatory and default rules which may be applicable are illustrated to the extent possible. While a comprehensive comparative law analysis is not contemplated or even possible, certain models are provided as useful examples under domestic general contract law or under contract types which may be applicable by analogy. The solutions provided by special legislation on production contracts receive particular attention, as well as good practices and industry standards because they point to critical issues and also offer possible solutions. Also, the approach reflected in recognised international instruments, such as the *United Nations Convention on Contracts for the International Sale of Goods, 1980* (CISG)¹ and the *UNIDROIT Principles of International Commercial Contracts, 2010* (the UNIDROIT Principles, or UPICC)² provide useful references.

8. While taking a concrete approach, the Guide aims to keep a certain level of generality regarding the various situations that may arise in contractual practice. It is acknowledged that contract farming may

1 References to CISG provisions in the Guide, unless otherwise indicated, are meant as a reference to a model text, and do not necessarily imply the CISG's applicability. More information about the CISG, including the text and an Explanatory Note, is available on the website of the United Nations Commission on International Trade Law (UNCITRAL) at http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html.

2 The Guide will occasionally make reference to the UNIDROIT Principles throughout the text, as representative of general principles of contract law, not intending to refer to their direct application. More information about the UPICC, including the text and an overview, is available on UNIDROIT's website at <http://www.unidroit.org/instruments/commercial-contracts/unidroit-principles-2010>.

differ depending on numerous factors (*e.g.* particular country or geographical region, the nature of the commodity and its biological cycle, the local or global nature of the market, and product ownership). Examples are used as illustrations wherever relevant. As an editorial and policy choice, the Guide refrains from making reference to specific countries, examples of legislation, case studies or quoting contract clauses, but refers to global international instruments promulgated under international auspices.

9. Readers will note that the Guide walks through the conceptual stages of the contract farming relationship. After first presenting the basics of contract farming in the Introduction and the legal framework in Chapter 1, the Guide presents in Chapter 2 the key characteristics of the parties involved in agricultural production contracts and discusses how agricultural production contracts are negotiated and formed, as well as what these contracts contain. More specifically, the various obligations bearing upon the producer and the contractor in the context of integrated relationships are discussed in detail in Chapter 3. Determining the consequences of a failure by the producer or contractor to abide by the terms of the contract naturally is the next question that arises. Accordingly, Chapter 4 explores excuses for non-performance and Chapter 5 examines remedies for breach of contract. Chapter 6 then covers issues related to the contract's duration, termination and renewal. Lastly, Chapter 7 discusses mechanisms for dispute resolution in the context of agricultural production contracts.

10. Beyond reading cover-to-cover, there are a couple of different ways in which readers may use the Guide. First, for readers with one specific question in mind, at the very end of the Guide, there is an analytical index which is organised by topics and sub-topics, with corresponding references to all of the places in the Guide that deal with that particular topic. Second, readers may wish to refer to a particular chapter or section via the table of contents at the beginning of the Guide. Third, readers may wish to browse through the text, following cross references to further treatment of topics of interest. Within the text of each chapter, there are cross references to highlight areas elsewhere in the Guide where a particular topic is treated in greater detail.

INTRODUCTION

I. General introduction to contract farming

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

2. Contract farming is a well-known mechanism to coordinate agricultural production and trade, but its use has increased noticeably in recent years. This growing interest in contract farming is associated with recent transformations in food and agricultural systems which make it increasingly difficult to meet consumer demands under more traditional, open-market-based procurement strategies. Demographic changes (in rapidly urbanising areas for example) and rising living standards have required increased food quantities. This increase in demand has led to scientific and technological developments, which in turn have significantly contributed to changes in market demand, the operation of supply chains and the production of raw commodities. The use of contract farming is expanding in developing countries, where it opens significant opportunities for economic and social development by providing local producers with access to markets and support in the form of technology transfer and credit facilities. Furthermore, contract farming is seen as a potential tool for reducing poverty, contributing to rural development and employment, and increasing food security.

3. Under a broad economic approach, “contract farming” generally refers to “a form of supply chain governance adopted by firms to secure access to agricultural products, raw materials and supplies meeting desired quality, quantity, location and timing specifications, whereby the

conditions of exchange are specifically set among transaction partners by some form of legally enforceable, binding agreement. The specifications can be more or less detailed, covering provisions regarding production technology, price discovery, risk sharing and other product and transaction attributes.”³

4. This definition of contract farming focuses on the coordination between the different parts of a supply chain, involving various participants and contract modalities. However, contract farming is different from direct sales between producers and buyers through open market spot transactions where the product is delivered immediately against a price. Indeed, contract farming relies on agreements that are made either during production or, more often, before it begins, thus providing certainty for the future delivery and supply of the product. Various contract patterns serve this function in practice. While some contract patterns rely upon traditional relationships, either based on the future sale of the produce or entitlement to the produce arising from granted use of land or animals, contract farming is among the new forms that have developed to meet the changing needs of the economic environment.

5. While acknowledging that the concept of contract farming can be very broad (as discussed further in Section II. Scope of the Guide, paras. 35-37 below), the Guide focuses on a particular modality of agricultural production based on an agreement between a producer and another party – typically an agribusiness company. Under this agreement, which is designated as an “agricultural production contract,” the producer undertakes to produce and deliver agricultural commodities in accordance with the contractor’s specifications. 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.

A. Various contract farming operations in practice

6. Contract farming may take several forms depending on many factors, from the perspective of the global environment and the particular

³ Da Silva, C. *in: The growing role of contract farming in agri-food Systems development: drivers, theory and practice*, Agricultural Management, Marketing and Finance Service FAO, Rome, 2005.

conditions of the transaction involved. There are significant differences between the world's regions and countries and their level of economic development, which influences the structure of the agricultural sector and markets. In advanced economies, the use of contract farming has intensified following agricultural industrialisation in the second half of the twentieth century. This was accompanied by important technological innovations in transport, logistics and telecommunications and by the development of credit opportunities to enhance investment in the production sector. Among other trends in advanced economies, participants in the processing and marketing sectors are increasingly concentrated at both the domestic and international level; markets, too, are increasingly interconnected and subject to common standards for quality and traceability. On the other hand, in emerging and developing countries, contrasting realities may prevail. Certain market features there may reflect some of the most advanced models of contract farming present in industrialised countries. Yet, these features sometimes coexist with traditional forms of production involving small producers. With respect to the characteristics of the transaction involved, a set of factors may influence the particular conditions surrounding an agricultural production relationship. A number of these elements relate to the characteristics of the parties themselves, and are further developed in Chapter 2.

7. Different models have been proposed to characterise and describe the structure of contract farming, in particular in the context of developing countries. These models include the centralised, nucleus estate, multipartite, intermediary, and informal models.⁴ The centralised model involves a centralised contractor buying from a large number of small producers, typically with strict quota allocation and tight quality control. Although similar to the centralised model, under the nucleus estate model, the contractor also manages a central estate or plantation which is used to guarantee downstream customer commitments in the case of shortfalls from producers or to ensure a certain level of minimum throughput for processing plants. Nucleus estates can also be used for research, extension or breeding purposes. Next, the multipartite model can involve several partners including Government and non-Government bodies or private companies (including those responsible for credit

⁴ Eaton, C. and Shepherd, A., in: *Contract Farming: Partnerships for Growth*. FAO Agricultural Services, Bulletin 145, Rome, 2001, pp. 44 *et seq.*

provision, quality management, processing and marketing, potentially all jointly participating in contracts with producers). The informal model describes the case where individual entrepreneurs or small companies make simple, verbal agreements with producers on a seasonal basis, perhaps benefiting from Government-sponsored extension services to support producers. Lastly, the intermediary model represents a variation on the aforementioned models where a collector (or other intermediary such as a non-Government organisation) is used for dealings between the producer and contractor.

8. Virtually any commodity may be produced under an agricultural production contract (including crops, livestock, aquaculture and forestry), for human and animal consumption, as well as for industrial use. The commodity's particular nature invariably has important implications for the individual contract's content and overall design, in particular for each party's obligations. The Guide does not intend to cover all specificities for each type of commodity. However, certain general characterisations can be made for broad categories of commodities, which are likely to determine certain features of the agricultural production contract.

9. Production of commodities intended for human or animal consumption (including for the cosmetic and pharmaceutical industries) involves compliance with safety requirements (see Chapter 3 at paras. 57-59). In particular, perishable goods are often produced under contract, as they require fast and efficient coordination with the marketing stage. However, they involve increased risks during the production phase and in the handling process as well as particular time constraints to keep the quality high and the product safe. To prevent risks and hazards, compliance with standardised protocols is required for many commodities. It is necessary to apply control and intervention procedures under the hygiene and food safety regulations of destination markets. Such aspects may be regulated under the contract by reference to voluntary standards such as good agricultural practices. Engaging in the production of such commodities generally requires a certain level of skill on the producer's part and strict compliance with quality conformity and traceability obligations. It also generally entails a rather intense level of support by the contractor in providing specialised inputs as well as technical assistance and supervision.

10. Many commodities require large capital investment in facilities and other fixed assets such as equipment for production and post-harvest operations (*e.g.* tractors and other machinery, irrigation systems, or

barns). For that purpose, in particular where specialised credit institutions for agriculture are lacking and access to credit for producers is limited, contractors may provide financing to the producer. Such financing typically places a repayment obligation on the producer. In light of the producer's exposure to what may be substantial investment risks, it is important that the parties carefully consider aspects of financing obligations, as well as duration, renewal and termination of the contract (see Chapter 3 at paras. 87-91 and Chapter 6 for further discussion).

11. Of course, commodities have different production cycles, which have implications for agricultural production contracts. Some commodities entail a cycle of a few weeks, while others would last over several years, as is typical for many tree crops and forestry production. This will generally determine the contract's duration and, coupled with other contractual terms, may strongly influence the parties' perspective towards relying on stable relations (see Chapter 6 at paras. 4-10).

12. Labour-intensive commodities are generally seen as particularly appropriate to grow under agricultural production contracts, especially when a certain level of care is required in manual handling during the production phase or in post-harvest operations (such as sorting, grading, drying, and packaging). In these cases, there may be added benefits for buyers that contract with small and family farms, particularly in developing countries. Crops or livestock that depend on close, intensive care during the growing season or rearing cycle often rely on family labour and typically can be more efficiently produced on smaller farms than on larger ones that depend on hired labour. Based on this feature, countries where the cost of labour is low are particularly attractive for investors to develop high value-added, differentiated products for specialised domestic or export markets. Horticulture provides an example of such commodities.

13. From a similar perspective, agricultural production contracts are often used where it is important to be able both to trace the origin of the goods, and ascertain whether it has retained certain characteristics throughout the supply chain. Identity-preservation is the designation given to bulk commodities marketed in a manner that isolates and preserves the identity of a shipment. This may apply to value-added commodities (such as organic products), to specialised varieties often requiring the use of special technology or production methods, or else to new commodities for new markets, which may be tested on a rather small and closely monitored basis. Producing these types of commodity

generally entails more stringent and cumbersome obligations upon the producer for complying with performance standards – regarding both the final product and the production process, with strict traceability requirements, and often subject to third-party verification. It may also entail obtaining particular technology transfer licences, assuming confidentiality obligations toward third parties, and complying with obligations deriving from the contractor's proprietary rights (based on ownership, patents and other intellectual property rights over the product). Generally, such commodities will be contracted on an exclusive basis, meaning that the whole production is to be delivered by the producer, very often including any non-conforming share of the produce, as well as wastes and residues (see Chapter 3 at paras. 18-21).

14. A broad category of commodities is intended not for human consumption, but for industrial use (such as those for the textile and chemical industries). In addition, with the growing demand for renewable energy sources, the planting of crops for bioenergy production has also increased considerably. While such crops are often grown through intensive agriculture in large plantations, investors increasingly rely on contract farming. Also, the wood-based industry is turning to contract farming for securing its supply of raw material, which is also seen as potentially contributing to sustainable forest management. While not being restricted to these particular crops, it may be noted that Governments often participate in investment plans and sometimes participate in regulating the individual contracts, in consideration of the economic, social and environmental implications involved.

B. Benefits and risks of contract farming

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

16. However, contract farming may also involve several risks and adverse effects. Improper use of the credit provided by the contractor might lead to unsustainable levels of indebtedness for the producer. Changes in working conditions may affect the producer's family or workers and raise concerns in several countries. Labour issues are likely to have sensitive implications especially when the local regulatory framework is weak and does not provide adequate protection to the producer or the community. Depending on the particular context, if not adequately protected, women may not benefit fully from the potential advantages that could accrue from contracts. Also, switching from subsistence farming to cash crops might cause problems related to monoculture production (such as loss of biodiversity and even a threat to the producer's own food security). Contract compliance issues can be exacerbated by difficulties related to contract enforcement and dispute resolution procedures. Judicial dispute resolution is rarely used in the contract farming context in developing countries (see Chapter 7 at paras. 46-8) as disputes often relate to factual issues arising from lasting relationships involving relatively low financial amounts. On this basis, obtaining redress from a judge is generally very lengthy, can be costly, and thus is often avoided by parties.

17. It is in view of contract farming's potential advantages, but also to limit its risks, that several Governments are directly engaged in contract farming schemes, provide targeted incentives to investors and producers as part of economic and social development programmes, or else have developed special regulations dealing with particular aspects of the parties' relationship (see Chapter 1 at paras. 7-10).

18. The sections below offer a general overview of the advantages and potential risks that may arise in the contract farming context. Special attention is paid to the agricultural production contract as a tool for risk mitigation and transferring technology and know-how, and as a credit and financial vehicle that can contribute to economic, social and environmental development.

1. Risk mitigation

19. One of the main benefits for parties participating in an agricultural production contract is that it allows them to effectively mitigate risks involved both in the production and marketing of the produced commodity. Through the contract – or the collective sum of individual contracts – the contractor secures on a regular basis the product supply

required to optimise the capacity of processing facilities, the management of stocks and delivery consistency to its customers. By organising the production upstream, the contractor can plan delivery of the needed product quantity under the required time schedule, which helps it to protect against market fluctuations. In addition, the contractor ensures that the product meets designated quality requirements, both with respect to the particular variety and its conformity to designated attributes. It also ensures compliance with regulatory and voluntary standards in relation to food safety and increasingly to social and environmental issues. Traceability and certification are increasingly used or required to provide evidence of compliance.

20. Under the agricultural production contract, the producer may acquire greater certainty regarding market availability, based upon the contractor's commitment to acquire the product, often coupled with an exclusivity clause which entitles the contractor to the producer's entire production (see Chapter 3 at paras. 18-21). In this way, the producer can rely upon a more predictable income and better organise its production activity. From the producers' perspective, market fluctuations can be avoided and new opportunities may arise for developing different commodities and accessing new markets. As a result of transferring certain responsibilities under the contract to the contractor, either when the contractor acquires decision-making power or as a result of the allocating shared responsibilities and control under the contract, the producer may be able to reduce its production-related risks and uncertainties. For example, the contract might require the contractor to bear part of the loss in the case of an unexpected weather event that damages the crop.

21. From both parties' perspectives, compliance is related to the expected benefits deriving from successful relationships and the incurred risks in case of breach. When relationships are built for the long term and offer sustainable mutual benefit to the parties rather than short-term benefits, contract breach is less likely to occur, as parties have incentives to comply with their obligations, rather than putting the relationship at risk.

22. It often happens that medium or large-scale processing or marketing companies with advanced management capabilities deal with large numbers of small or medium-scale producers, thereby spreading risks of loss. Producers, on the other hand, may have little or no opportunity to contract with another party if the contract fails or is not

renewed, and they may have little flexibility to sell to other buyers even if better prices are offered. Although this possible scenario illustrates that the risk mitigation methods chosen by one party may not always benefit the other party, it also illustrates and the need for positive management attitudes regarding risk sharing on the contractor's part, coupled with support from producers' representatives.

23. The risk mitigation potential from contract farming may also extend to the area of land ownership. When defining their business strategy, food manufacturers and investors may have recourse to contract farming rather than directly investing in land acquisitions or long-term leases. In certain contexts, land deals are subject to restrictions, in particular for foreign investors, while where possible, owning or directly managing the land involves large sums of capital and may entail related liabilities that the investor could be unwilling to face. Additionally, growing global awareness on issues related to large-scale land acquisitions or long-term land leases has made potential contractors less likely to resort to such acquisitions in developing countries, fearing possible negative social or political backlash. In many situations, however, investors develop contract farming operations alongside direct farming on the plantations they control, mitigating risks both related to production and negative public reputation simultaneously (see para. 7 above on the nucleus estate model of contract farming).

24. As mentioned above, risk mitigation differs from risk allocation. The risk mitigation strategies employed by one party do not always lead to risk mitigation for both parties and can shift the risks from one party to another. Concerns about risk allocation between the parties can be viewed within the context of broad policy considerations (for example who typically is in the best position to manage and cope with risks, and whether a certain risk allocation will endanger the relationship's mutual profitability). Often, the contractor is in a better position to bear some risks, because the larger structure and greater resources allow the contractor to absorb more risks without endangering its own viability. Conversely, in some cases, shifting even minor risks from the contractor to the producer might endanger the contractual relationship as a whole, when the small-scale producer is incapable of shouldering the added burden (see Chapter 3 at paras. 6-21 for a more detailed discussion of risk allocation through contractual obligations).

25. To understand fully the mechanisms for risk mitigation and risk allocation in an agricultural production contract, the contract must be

viewed in its entirety. A long-term contract which guarantees continuous access to the market and a steady product supply might have a relatively lower price term than a shorter-term contract. Similarly, an insurance scheme built into a contract (such as one to cover for chick mortality in a poultry contract) can effectively mitigate some risks for one party, but might also entail a lower final price to balance the risk allocation between the parties. Therefore, the parties are well advised to discuss openly and honestly the relationship between the different possible clauses for mitigating the risks involved, to foster trust and to help better understand the contract.

2. Access to credit

26. Another important aspect of contract farming is its potential function as a credit vehicle. Contract farming promotes supply chain financing by facilitating the provision of credit to producers and to contractors, with derived benefits for all participants in the chain. A typical feature is the provision of working capital by the contractor, either directly or by guaranteeing third-party provision, in the form of inputs (such as seeds and seedlings, fertilisers and other chemicals, and animals and veterinary products) and services (such as land preparation, planting, harvesting or produce transportation) on advance terms over future delivery (see Chapter 3 at paras. 64-72). As a result, a producer can begin production without facing up-front payments that it may otherwise be unable to afford. This is particularly likely to be the case for small producers and those who cannot offer a security over the land and would therefore be unable to obtain credit from many commercial banks.

27. In many cases, the producer could also use the contract and future revenues derived from it to acquire or increase its creditworthiness towards third-party credit providers, such as microcredit or commercial banking institutions. In some systems, instead of granting a pledge right over the land or the production itself, the producer can grant a lien over the future revenues to third-party creditors. Alternatively, the contractor can stand as a guarantor or may make direct payments to the bank in discharge of the producer's debt, based on the producer's assignment of rights to the benefit of the bank. Sometimes, Government entities can also be involved, sponsoring the overall arrangement or guaranteeing loans as part of a public development programme. The contractor, on the other hand, can sometimes use the agricultural production contract to obtain credit from a bank. Thus, in some cases, the contractually set

forward price for the amount of future receivables can then be used to secure a bank loan.

28. In certain situations, however, the provision of credit itself might bring additional risks for the parties, either by creating high levels of producer indebtedness, or when the producer is incapable of repaying advances provided by the contractor or reimbursing capital investment loans made to meet the contractor's requirements under the agricultural production contract. These problems might either emerge after a poor seasonal production and unexpectedly low prices on the market, or more generally from unfavourable clauses drafted by the more powerful party, highlighting the possible issues stemming from market fluctuations and power imbalance. Naturally, the producer's inability to repay large advances may also be financially burdensome on the contractor, who might have trouble covering the lost income as well. Similar problems also arise when the producer chooses to side-sell the production that had been financed beforehand by the contractor. In this case, the contractor loses both the advances and the final product.

3. Technology and know-how transfer

29. Agricultural production contracts can improve access to markets by introducing producers to more recent technology and important know-how. As part of the technology provided, the contractor often provides inputs to the producer and may also provide technical and management services to sustain the producer's productive capacity and obtain higher yields and better product quality at a lower cost. In certain occasions, however, the contractor will instead rely on the producer's particular skills or know-how (see Chapter 3 at para. 81).

30. Also, in consideration of sophisticated technology's increasing use in agriculture, contractors can use provisions in the contract to organise the production process themselves and ensure that the producer applies designated methods by monitoring the production process and providing training as necessary. Particular contractual structures or terms can enable the contractor to protect its title over goods or processes, such as ownership or intellectual property rights over seeds or animals (see Chapter 3 at paras. 8-12 and paras. 95-104). Largely as a consequence of these two features, contract farming is often a suitable mechanism for developing new commodities for new markets, or for introducing innovative production methods and, very importantly, may offer the producer access to the contractor's agronomic technology and know-

how, which is needed for specialised production and markets. In many situations, by using the technology granted and know-how provided, the producer could find itself in a stronger position to engage or continue new production even after the contractual relationship has ended. It should, however, be kept in mind that technology transfer to producers may be limited by issues related to intellectual property rights.

31. In some contexts, there may be risks for both parties arising out of the introduction of new varieties, technology and intensive production, that may entail disruption of the traditional methods and livelihoods. The parties to an agricultural production contract should be sensitive to the economic, social and environmental circumstances into which they are introducing the use of new technology and know-how.

4. Economic, social and environmental development

32. At a global level, contract farming has the potential to create economic wealth, to contribute to supply chain efficiency through the production of higher quantities of better quality products, and to contribute to achieving food security objectives. Contract farming generally sustains family farming by allowing agricultural producers to keep working on their own land. This dimension has a particularly far-reaching impact in developing countries where contract farming opens opportunities to small-scale producers to move away from subsistence production to commercial production. Contract farming may foster social objectives reflected in specific standards. Contractual obligations on the parties can, for example, encourage the formation of producer groups or associations to strengthen the capacities of small-scale producers; to ensure better work conditions for labourers; or to foster the inclusion of certain categories of persons (for example women, or traditional communities). Environmental concerns, which are increasingly a focus in global supply chains, are also present in contract farming. The parties to agricultural production contracts are paying greater attention to the environmental sustainability of production practices, often beyond legal requirements.

33. It is important to ensure that contract farming activities do not undermine key substantial aspects of food security and nutrition (such as local biodiversity that guarantees the existence of diverse and sustainable diets and ensures adequate nutrition). In contract farming activities involving monocropping, best contractual practices would protect the local food supply availability by leaving a portion of the producer's land for subsistence production. This practice could limit monoculture's

negative impact and guarantee direct access to food when high prices affect local markets.

34. Moreover, contract farming, if implemented consistent with the 2011 UN Guiding Principles on Business and Human Rights, could positively influence the realisation of the right to work and improve rural working conditions. By promoting smallholder farmers' access to markets, contract farming contributes to increased productivity. Contract farming thus contributes to better incomes for smallholders, to the creation of new jobs, and to overall rural employment stability. Furthermore, contract farming can be an important channel for expanding the application of international labour standards (ILS) to rural workers. Agricultural workers are often not covered by some aspects of labour legislation at the domestic level. Furthermore, the majority of poor and disadvantaged workers in the agricultural, forestry and fisheries sectors are employed in the informal economy and may be excluded in practice from many of the protections afforded by labour legislation. Extending international labour standards through agricultural production contracts to agriculture and related rural occupations offers a possibility to promote better working conditions in rural areas, as well as facilitating and providing incentives for formalisation. This would extend internationally required labour rules to both agricultural workers covered by domestic labour laws and those who are not (such as people participating in family-based small-scale agriculture). In particular, Governments can promote sustainable agriculture, better and safer agricultural practices to reduce hazardous work, as well as labour saving practices and technologies that reduce dependence on child labour and the work burden on women. Responsible contract farming arrangements can represent an important instrument in this sense. Conversely, if adequate guarantees and monitoring are not provided, workers may suffer from poor terms and conditions, especially women workers, and there could be an increasing incidence of child labour.

II. Scope of the Guide

35. The concept of contract farming can be very broad and agreements may vary widely. However, the Guide does not intend to cover all possible agricultural contracts or all of the contract varieties that could possibly fall under contract farming's umbrella. Instead, the Guide limits its scope to focusing primarily on the bilateral relationship between producer and contractor, referred to in the Guide as an agricultural

production contract. Certain characteristic features distinguish the agricultural production contract from other contract structures or types which may already be known and well defined under domestic settings.

A. The agricultural production contract under the Guide

36. The agricultural production contract upon which the Guide focuses typically involves two parties: a “producer” directly involved in the production of agricultural products as an independent person or enterprise; and a “contractor,” committed to purchase or otherwise take delivery of those products – typically an agribusiness company engaged in processing or marketing activities. However, the agreement may be part of a complex transaction involving other parties (for example several producers, a public entity, an input supplier, or a banking institution). As a result, separate contractual relationships may either have an influence on, or be themselves affected by the agricultural production contract. The participation of other parties is discussed in the Guide, only insofar as it may affect the mutual obligations and remedies of the producer and the contractor.

37. The parties enter into the contract before the production begins, and the contract is often set for a fixed term, either for one production cycle or for several or many production cycles. In successful contract farming projects, terms are usually reviewed annually. However, each contract period is generally part of a lasting relationship rather than a one-off transaction, as the parties typically organise their activities (and in particular the infrastructure needed and related financial commitments) with a long-term perspective. Issues related to the contract’s duration, its termination and renewal are discussed further in Chapter 6 of the Guide, while those related to price, which can be determined at different times under various formulas, are addressed further in Chapter 3. A feature which distinguishes an agricultural production contract from other arrangements (such as classical forward delivery contracts), is the fact that the contractor not only provides specifications regarding the final product – its quality, quantity and time of delivery – but will typically also seek to exert a certain degree of influence over the production process. This aspect is further developed in the following section.

B. The contractor’s involvement in production

38. Under an agricultural production contract, the contractor will typically exert some level of control and guidance during the production

process. This would typically relate to one or several of the following elements:

- provision of particular physical inputs (seeds, fertilisers, pesticides, young animals, veterinary products, etc.) that the producer must use for the contracted production; alternatively the contractor may designate what inputs should be used, including the suppliers of such inputs;
- provision (either directly or through a subcontractor) of certain services on the production site (such as soil preparation, harvesting, etc.); provision of technology (know-how and use of patent and intellectual property rights) and technical assistance;
- provision of financial support such as advances (typically inputs on credit terms), loans, guarantees, etc. generally to help the producer with production costs; and,
- participation in the production process, through interventions with planning, providing instructions, directing, monitoring and supervising certain essential operations or the whole process, involving advising and training the producer, and inspecting and verifying compliance on the production site during the process.

39. The various possible combinations of the parties' obligations and in particular the intensity of control exerted by the contractor may determine different economic patterns, ranging from a collaborative form to an integrated structure. The latter pattern refers to a quasi-vertical integration that is commonly found in contract farming operations. The particular market and commodity and the business structure sought by the company will influence greatly the level of integration. Very tightly integrated relationships are likely when contractors are fairly or highly concentrated and competing in a particular market and have developed specialised lines of products requiring specialised raw materials and production methods that have been developed by the contractor and confer on the final product a specific market identity. The various obligations bearing upon the producer in the context of integrated relationships and their legal implications are discussed under Chapter 3. In certain situations, however, the nature and intensity of the links between the parties may lead to conclude to a specially characterised relationship, which is illustrated below.

C. *Distinguishing agricultural production contracts from partnership and employment relationships*

40. As understood in the Guide, an agricultural production contract assumes legally independent parties. Thus, in the case of integrated relations, the degree and form of control exerted by the contractor should not modify the relationship's legal nature into one of legal dependency, which would fall outside the Guide's scope. This could occur, depending on the legal characterisation and judicial interpretation under domestic law, in two different situations: a partnership scenario and an employment scenario.

1. *Agricultural production contract versus partnership*

41. While economically linked to and dependent upon the contractor as an independent legal party, the agricultural producer should keep autonomy in terms of assets and management over the undertaking. When the nature and degree of control by the contractor calls into question the reality of the producers' legal autonomy, the conclusion may be made that a common venture has in fact been created between the producer and the contractor. This common venture is sometimes referred to as a partnership, a *de facto* company or as other similar concepts. This could occur, for example, when the contractor is seen to have direct ownership of the whole activity, as a result of holding ownership or proprietary rights over both the tangible and intangible assets needed for the business' operation (*e.g.* the inputs, the technology, the process and, through exclusive rights, the future product).

42. When, under the applicable law, the contractor and the producer are viewed as forming one single entity, the contractor could potentially be exposed to liabilities normally attached to the producer, and may provide the grounds for claims by third parties upon the producer's default. Even if rare, this could apply to the producer's general debts, in particular towards the producer's employees, who may come under a direct employment relationship with the contractor. In such situations, the contractor might become liable for compliance with responsibilities derived from labour and social regulations.

2. *Agricultural production contract versus employment*

43. When the producer is a natural person and the contract imposes tight control by the contractor, the applicable law may characterise the

particular relationship as an employment relationship, entailing the comprehensive application of labour and social laws with possibly significant financial obligations for the contractor. The characterisation of “employment,” the rights and protection deriving from the employee status, and the applicable rules differ widely across countries. At the same time, in many industries, companies increasingly externalise activities and functions to independent parties based on contracts, while ensuring that contracted parties comply very strictly with the agreed objective, with a view to higher technical and cost efficiency. Employment relationships fall outside the Guide’s scope.

44. To determine the existence of an employment relationship, domestic labour, social and legal frameworks set forth broad criteria that apply as a matter of public policy. Very often, domestic laws have special rules applicable to employment in agricultural undertakings, as well as to labour inspection.⁵ Most often, the relationship’s legal characterisation depends upon the interpretation made by courts, primarily based on the facts and economic reality, irrespective of the particular arrangements or actual designation used in the contract. It is in fact common that contractors include an express clause in the production contract referring to the producer as an “independent contractor,” or contain a specific clause to the effect that the producer is not an employee or an agent of the contractor, but such clauses may not be valid under the applicable law or may not be binding on a court or public authority for the purpose of determining the nature of the relationship.

45. Criteria commonly found under domestic legislation to characterise an employment contract generally relate to concepts such as subordination, economic dependency, integration within the business organisation and absence of financial risk. Subordination may arise from the employer’s authority and control in determining how and where the work is carried out, extended direction and supervision powers, evaluation of results and application of disciplinary sanctions, and often the provision of working tools and materials. Some of these elements are often present under an agricultural production contract, where the contractor can supply several inputs, and would have close technical control of the process. It would generally be considered particularly relevant – and indeed lead to characterising the producer as an

⁵ For example, at the international level, see the ILO Labour Inspection (Agriculture) Convention, 1969 (No. 129).

employee – when the contracted tasks are performed on the contractor’s premises. However, depending on the particular circumstances, even when the production is performed on the producer’s production site, it could still be found that the nature of the contract is that of employment taking place at the home of the employee.

46. Also, economic dependency appears as a frequent criterion for characterising employment contracts, which could be established, in particular, when services are provided on a personal and exclusive basis with remuneration being the sole source of income. These elements may indeed also be found under an agricultural production contract. Financial risks borne by the producer, however, might generally point to an independent undertaking. Financial risk could be inferred from responsibility incurred for management and capital investment (which could be evidenced, for example, when insurance coverage has been obtained) with the related opportunities for financial gains (as opposed to fixed remuneration).

CHAPTER 1 – THE LEGAL FRAMEWORK

1. Generally, parties are free to structure their contracts how they see fit, based on the widely recognised principle of freedom of contract. This freedom, however, may be limited both by private law rules and the broader regulatory environment. Domestic contract law rules include several mandatory provisions, from which the parties cannot deviate, but largely, they consist of default rules that provide solutions for matters not specifically addressed by the parties. Understanding how a particular agricultural production contract is regulated will help parties consider potentially applicable mandatory provisions and default rules, and thus draft better terms for their contract. It will also help parties trying to resolve disputes, especially with respect to interpretation issues and the identification of available default rules.

1. The applicable private law regime

2. Most agricultural production contracts establish purely domestic legal relationships, meaning that all contractual elements are located in or produce effects in a single country. Typically, agricultural production contracts have strong ties to the producer's country of domicile or residence. The producer may be a national of that country, and the essential obligation under the contract, namely producing the designated commodity, takes place on the land or installations owned or controlled by the producer. Several other elements forming part of, or related to, the contract are likely to take place in or be linked to that country. This applies, for example, to the contractor's place of incorporation or registration. Even when the contractor is part of a multinational group, the contractor generally conducts its operations through a local subsidiary, which is a separate legal entity. This also applies, as another example, to the place where the contract is negotiated and entered into, where the agricultural products are delivered and where the payment is to be made.

3. Based on the strictly domestic character of the contract, the rules of the producer's domestic legal system will usually apply, including both mandatory and default provisions. This will be true not only when the

parties have expressly referred to the domestic law, but also – as is most often the case – when the contract is silent in this regard. It should be noted that there would normally be no advantage for the parties to choose or seek the application of a foreign law to regulate their contract, and indeed it is unlikely that they would be authorised to do so in many jurisdictions. The choice of the domestic legal system, by express provision or by default, may generally foster the parties' access – particularly for the weaker party – to justice and procedural protection, both during dispute resolution procedures and at the enforcement stage (see Chapter 7 for further discussion of dispute resolution).

4. The domestic legal system is also likely to apply to most legal situations involving parties other than the producer and the contractor. This includes parties participating in production contract performance based on the same agreement, or under separate contracts. The labour force hired by the producer falls under this category. The domestic legal system is also likely to apply to agreements for the provision of credit, inputs or services. Furthermore, third parties may potentially have a liability claim against the contractor or the producer as a result of the agricultural production contract's performance. This may occur, for example, when the production site or its surroundings – located within the domestic jurisdiction – suffer environmental damage. Defects in the agricultural product which have an impact on other participants in the value chain (such as consumers) may be another possible ground from which liability may derive. However, when the products are marketed in a foreign country, this international dimension may lead to the application of a foreign law, a situation discussed in more detail at the end of this section at paras. 33-40.

A. Legal treatment of agricultural production contracts

5. Determining what legal regime applies to a particular contract involves ascertaining whether the relationship may be classified as one legally defined contract type under the applicable law. Special contracts are regulated by particular sets of rules including both mandatory and default rules, which may differ from those that apply generally to contracts. Typically, deviations from general contract rules relate, for example, to contract form requirements, the scope of the parties' obligations, price determination, or time limits). They may also involve consequences regarding aspects outside the contractual agreement (for example on the applicable tax regime).

6. One element which may determine a contract's classification under a specific legal system is the nature of the essential obligation that characterises the contract, typically whether it relates to the provision of goods or the provision of services. Complex contracts with more than one characteristic performance are often difficult to classify, and legal systems use different approaches to characterise the transaction. In some cases, the law itself may create a regime applicable to that particular transaction, which thus becomes "typified." When no such special regime exists, the relationship's mixed nature may lead to identifying different underlying contractual structures (*e.g.* "sales", "lease", "bailment") and, as a result, the overall relationship will be subject to a combination of contractual regimes, as if the identified contractual obligations were unrelated. Under a simpler, more straightforward approach, one particular performance may be considered as prevailing in the transaction, resulting in application of the legal regime corresponding to that performance to the entire relationship. Finally, under yet another approach, if the transaction's character is totally original (*"sui generis"*), rules concerning similar contracts will be applied by analogy and only to the extent compatible with the particular transaction.

1. Special category of contract

7. More and more domestic economic and social policies recognise the special nature of agreements between agricultural producers and contractors. Several countries regulate relationships through substantive rules, generally a combination of mandatory and default rules, thereby creating one or several specific types of contract. These regulations vary in nature and scope. While a number of them focus on produce marketing, others deal specifically with the prototypical agricultural production contract discussed in the Guide. Accordingly, special legislation might use different terms (such as "agricultural contract," "production contract," "integration contract," "aggregation contract," "contract farming," or "agro-industrial contract"). Leaving aside the diversity in terminology and focus, such special legislation is generally aimed at the common objectives of increasing certainty and transparency in contracts, protecting producers from unfair practices and encouraging parties to establish stable relationships in their mutual interest.

8. The specific legal treatment of agricultural production contracts may be implemented in many ways. Some domestic regulations consist of special provisions in a statute's contract law portion, while others are enacted through stand-alone legislation. Within statutes concerning

agriculture, land law, labour law, corporate law, tax law, commercial law, competition law or other law, special provisions may address the relationships between operators involved in primary agricultural production and the market, either to include expressly such contracts or, to the contrary, to exclude them from their general scope. Provisions on the private law relations between the parties are often included in a general statute on agricultural sector development that also covers several different aspects such as investment, finance, land tenure and producers' organisations. Such provisions can also be part of a statute designed to apply to a certain commodity, particularly when a public agency or board has regulatory powers over the commodity. In addition, private relationships are sometimes regulated through standard conditions approved by organisations representing professional interests, which are then given mandatory effect, either directly or through some form of approval by the competent Governmental agency.

9. Specific regulations on agricultural production contracts may contain requirements regarding contract form, as well as the parties' substantive obligations. Compulsory requirements regarding written form and minimum content attempt to strengthen the producer's negotiating position and to facilitate an assessment of the expected benefits and potential risks (see Chapter 2, Sections II and III. for further discussion of requirements for contract form and formation). In some cases, special regulations require the provision of certain pre-contractual information, in an attempt to minimise information asymmetry on important matters (such as production description, health and environmental requirements, and the activity's economic risks, estimated investments in facilities or growing areas for producing, and alternatives for loans). Transparency promotes fair conduct because it improves certainty regarding performance and non-performance conditions.

10. Providing for dispute resolution mechanisms, thereby seeking to ensure workable enforcement solutions and promote contract compliance is another common feature of special legislation (see Chapter 7 at para. 8 for further discussion). Substantive legal requirements attempt to restrict unfair practices and protect producers by affording them particular remedies or by restating general or specific principles included elsewhere in the law. While most legal systems leave parties with ample freedom to regulate their relationship, others attempt to achieve a balance of rights and liabilities between them through mandatory provision. Finally, some laws regulate collective contracts, which then become mandatory for all individual contracts entered into in the

corresponding sector. There may also be model contract forms annexed to the special legislation, intended either for individual or collective contracting.

2. Traditional contract types

11. Not all legal systems treat agricultural production contracts as a special category of contracts, and even those that do so may not regulate all the mutual obligations under an agricultural production contract in great detail. Therefore, for matters not expressly addressed by the parties, default rules may be drawn from rules governing traditional contract types, depending on which elements are found to be preponderant under a given contractual arrangement.

12. As seen above, under the applicable law, the nature of the parties' obligations may play an important role in characterising each performance, as well as the entire transaction. For that purpose, a distinction should be made between two broad contract categories: the first involves a transfer of ownership of goods from the producer to the contractor and the second involves the contractor's retention of ownership throughout the production process.

13. *Transactions involving a transfer of ownership:* Many agricultural production contracts, especially those for crop and vegetable production, rely on the mechanisms that typically characterise a sale transaction. Under a sale, the seller undertakes to deliver specified goods to the buyer, against the payment of a set price. The sale transfers ownership over the goods to the buyer, together with related warranties. Depending on the particular transaction, the producer could be either the seller delivering the production to the contractor, or the buyer of inputs – animals, seeds or plants – from the contractor. However, certain aspects often present in the context of an agricultural production contract may be critical in defining the legal regime of the whole transaction as a sale. It could be so where, as is often the case, the inputs supplied by the contractor account for a substantial amount of the materials necessary for the production, or where specifications under the contract not only concern the product at delivery but deal with processes and techniques to be implemented during the production, with the result that the preponderance of the producer's obligations consist of the supply of

labour or other services.¹ Another peculiarity of the agricultural production contract is that most often the product is individualised and cannot be supplied from a third party. How these various elements are assessed in characterising the contract will depend on each particular legal system.

14. *Transactions not involving a transfer of ownership*: This category typically encompasses livestock production where the contractor retains title to the goods, and under certain legal systems may also encompass high value crops (often protected by intellectual property rights). Depending on the objectives sought by the parties as well as under the applicable law, certain types will commonly be found to underpin agricultural production contracts that do not involve a transfer of ownership. Under certain legal systems, for example, the producer may be considered to provide “services” (*i.e.* to apply labour and skills using best efforts rather than being committing to a specific result), and the price would be set according to performance standards. In certain countries, especially for livestock production, particular types falling under the general categories of lease or loan would be applied and, under such agreements, the producer is granted use of the animals owned or managed by the contractor for a period of time, during which the producer would be responsible for their condition. In some common law jurisdictions, the application of rules on “bailment” provide the contractor with extended protections against the possible use, sale or other kinds of transfer by the producer – typically of seeds, special brand crops, or genetically modified produce – in which the contractor holds intellectual proprietary rights. The aforementioned types are mere examples as various other types may apply under any particular legal system, each involving a corresponding legal regime.

15. Where the parties would generally be free to choose a particular contract type to structure their whole relation or a certain part of it, certain types may be subject to mandatory characterisation, generally to the effect of applying mandatory provisions to meet public policy, economic or social objectives (for example protective rules in the interest of a weaker party). As already discussed, this is typically the case with employment contracts (see Introduction at paras. 43-46), and it is also the case in certain legal systems for agricultural production contracts (see Section 1 above). Also, depending on the methodology used under

¹ For international sale contracts, see the distinction under Article 3, CISG.

domestic law, a judge may consider the true economic objective pursued by the parties or the essence of the relationship requires the application of a different legal regime than the one designated by the parties.

B. Other domestic legal sources

16. Whether an agricultural production contract is treated as a particular category of contract, or is assimilated, in whole or in part, into traditional contract types, any particular agreement will be subject to various other legal rules. First and foremost, the parties will encounter several policy limitations, whether expressed in legislation or case law, which are designed to protect overriding social and economic interests. Domestic law may provide implied terms or default rules that are applicable to agricultural production contracts by virtue of different legal sources including statutory provisions, general principles, traditional and customary rules, usages and practices, and soft law. Other sources may also be relevant under domestic law. In particular, the interpretation given by courts is important in all legal systems, albeit in different extents. In some legal systems, legal doctrine is also an important interpretation source.

17. It is worth noting that certain countries recognise a plurality of legal orders within their boundaries. In federal systems, contract regulation often lies with the political subdivisions, but may be shared with the central Government. Also, many countries recognise legal pluralism, where the right of certain regions or communities to be regulated by specific rules applicable on the grounds of legal tradition or personal, ethnic, territorial or religious criteria. The scope and applicability of the rules under each particular legal order, and the manner in which possible conflicts between the various autonomous legal systems are to be solved depends on the country's constitutional system.

1. Rules and principles of law

18. General contract law will typically regulate fundamental aspects of the agreement, such as its interpretation, formation and validity, content or object, non-performance and remedies, limitation periods, assignment of rights and third party rights, as well as agency and restitution. These two latter concepts, however, may be found under separate categories of rules. It must be noted that provisions found under other legal categories may also be relevant in the context of agricultural production contracts,

such as real rights (dealing *inter alia* with ownership, possession and security interests) the legal capacity of natural and legal persons, tort liability, company law and, in particular contexts, family law or the law of succession. Laws related to court proceedings and alternative dispute resolution mechanisms will likewise be highly relevant.

19. Several mandatory rules will be relevant for dealing with unfair terms or practices in the context of agricultural production contracts. For example, within the ambit of contract law, provisions relating to the validity of contracts may find application, in particular with regard to defects in consent. When dealing with contract formation, special provisions may apply for standard form contracts to protect the interest of the party that did not draft the contract. In addition, in many legal systems, rules applicable to special contract types aim to protect the weaker party when uneven bargaining positions might lead to unbalanced contract terms or would enable the stronger party to use unfair practices.

20. Moreover, general principles of law may provide further guidance to parties. In many legal systems, the parties' freedom to agree on the contract's terms, or the exercise of rights under the contract, apart from possible limitations under mandatory law, may also be interpreted in accordance with principles or standards of conduct. More or less widely-recognised principles include: the principle of good faith; the principle of reasonableness; the preference for preserving the contract and its efficacy whenever possible, in accordance with its purpose and the original will of the parties; loyalty and fair dealing (often considered as corollaries to the principle of good faith); behaving in a consistent manner; and the duty of information, transparency, and cooperation between the parties. It must be emphasised, however, that the particular principles as well as their formulation, authority and scope vary depending on the features of each country's legal system, and may furthermore be subject to debate even within one single jurisdiction. Concepts such as fairness or equity in contract, for example, are not universal and do not always entail positive obligations, or may be subject to other interpretations or standards leading to different results from one country to another. It is widely recognised, however, that certain common concepts can be applied to reach the similar result of establishing or re-establishing a certain level of fairness between the parties, when this balance has been severely disrupted by profoundly unfair contract terms or acts.

21. It is generally accepted that certain requirements are reasonable or indeed necessary to protect a legitimate interest, and that certain types of conduct should not be accepted or should be sanctioned (such as acting in bad faith; abusing rights; using undue influence, pressure and unfair tactics; exploiting a much stronger bargaining position; not disclosing critical information; applying unilateral changes of practices; and many others). Generally accepted principles are also reflected in guidance instruments promoting good practices in business transactions or in food supply chains. It is worth noting that the parties may wish to refer to general principles in their contract, or to apply these principles to their relationship in general or for certain aspects.

2. Customary rules and usages

22. Customary rules may play a role in many legal systems, including cases where agricultural production contracts are entered into with local or indigenous communities or their members. Customary rules often derive from practices and traditions, may be neither codified nor written, and may deal with matters such as personal status, family relationships, inheritance, governance of land and other natural resources, and rights over livestock. Rights may also be collective and pertain to a whole group or community. With respect to contractual relations, customary rules may deal with the capacity of persons to enter into an agreement (restricting, for example, the rights of women in certain contexts), the validity of agreements, issues of form and evidence, or performance and sanctions for non-performance. Internal enforcement and dispute resolution mechanisms are often in place. It is important, therefore, to acknowledge that the local culture and private institutions might, in some situations, prevail over statutory law or case law.

23. Customary law is recognised in several countries, often by the domestic constitution or other statutory provisions. The applicability and scope of these rules, how they are recognised, and how possible conflicts between the various autonomous legal orders are to be solved, depend on the particular features of each country's legal system. Very often, however, no definite rules regulate the application of such law, which therefore only govern relationships between members of the particular community of people. In other settings, customary rules may be applied by courts as local customs or usages and these two concepts are often conflated. Even when a particular practice or tradition does not legally amount to a custom, parties should take them into account carefully in

their dealings, especially when the relationship has a strong social, cultural and personal dimension.

3. Trade usages and practices

24. Usages may also refer to common practices and terms in transactions taking place in a particular trade or industry, such as for particular commodities. Depending on the circumstances, relevant usages may be local or international. Under most domestic legal systems, usages and practices are included by statute among the possible sources that courts can or must apply to a particular contract or contractual terms. Legal systems differ widely on the level of recognition and authority conferred to unwritten usages, which generally rely upon judicial practice. As a general principle, the application of usages should not be unreasonable or contrary to positive rules of law or to the contract's express terms or general content. However, usages have been invoked by courts in some instances to interpret the plain language of an express term (for example to the effect of allowing for a certain degree of flexibility in the specified quantity delivered, or the time of delivery).

25. Whether a specific usage can in fact be relied upon to fill missing terms in a contract or construe its terms is a question that raises complex issues regarding the actual existence of the alleged usage. Such a determination is usually made by examining its effective and constant application by similar parties, and evidence that the parties were aware of it and could be expected to observe it. Here, the rules of evidence are crucial and depend on the particular situation as well as the procedural rules applied by the court. In certain instances, documents such as standard contract forms, general conditions or professional standards will be considered as reflecting usages, if they fit within the criteria established by the applicable law.

4. Standard terms and guidance documents

26. Standards to be applied directly by contracting parties, or rules providing more general guidance to them and sometimes to other stakeholders, may be found in (a) model contract forms or conditions, (b) technical standards, and (c) various instruments such as codes of ethics and conduct, which have a non-binding character and are designated as soft law instruments.

(a) Standard contract terms and contractual documents

27. Standard terms and contracts may be drafted by private entities such as trade associations – especially those focused on a particular commodity – professional organisations, non-Governmental organisations, or individual commercial firms. Preferably, the standard drafting would involve a wide set of actors, representing both producers and contractors. Standard contracts may also originate from public entities (such as international organisations or Government agencies, or bodies formed by stakeholders from various sectors). Generally, compliance with such standard contracts is monitored by an internal or external body, which may also serve as an enforcement authority.

28. In certain contexts, some countries have chosen to allow industries to self-regulate to a certain extent by using standard terms and guidance documents. The underlying rationale is that private firms may have better knowledge for drafting contractual provisions in accordance with practical needs. To ensure that the standard terms and guidance documents are unbiased and balanced, the participation and the process must be both voluntary and transparent.

(b) Technical standards

29. One important group of standards encompasses technical requirements for product quality (defining, for example, safety targets or attributes in response to particular dietary or religious requirements), and quality and safety management systems, which establish criteria and impose procedures to prevent and control risks and ensure traceability throughout the production and transformation processes (see Chapter 3 at paras. 47-56 and 105-108). Several standards also address recommended conduct in contractual relations, in particular with respect to human rights, environmental issues, labour conditions and other social concerns, resulting in specific obligations that go beyond the level required by applicable public regulations. Very often, standards concern categories of commodities, and may combine objectives relating to different areas. Standards are typically not country specific, although they may address particular problems that are more likely to arise in certain contexts than in others.

30. Certain global schemes and technical production standards have gained wide recognition and are increasingly applied on a voluntary basis, leading to greater harmonisation across parts of the world. In some cases, they have even been made compulsory by Government regulations. In that situation, or when the parties include them as express terms or by reference in their contract, what was originally soft law and

voluntary regulations becomes binding upon the parties. Even when there is no such express application, recommended practices could be seen as applicable usages. Likewise, standards may enjoy wide recognition because of the authority of the entity that developed them or their intrinsic quality.

(c) *Soft law*

31. In several countries, Governments have increasingly sought recourse to soft law as an alternative or an addition to mandatory regulations, in order to promote fair contractual practices in commercial or business relationships in general, or more specifically between suppliers and buyers in the food supply industry. Soft law includes, for example, principles by inter-Governmental organisations that seek to create a link between the public sector, the private sector and civil society groups, whereby Governments are informed of certain basic criteria that need to be fulfilled in order to build the producer's capacity and skills. Depending on the jurisdiction, soft law instruments consist of recommendations by a Government entity, or voluntary codes of practices or good conduct that rely on collaboration with stakeholders for their preparation and implementation. Monitoring and enforcement mechanisms are sometimes put in place to encourage and report on adherence to the voluntary rules, which generally brings reputational benefits. On the contrary, failure to comply may be sanctioned through disciplinary measures, typically by reduced membership rights in the association supporting the voluntary scheme. Furthermore, in some cases, dispute resolution procedures are available under these voluntary schemes.

32. In addition, international instruments that are not directly applicable may still be relevant as soft law. In the area of private commercial law, in particular contract law, even though they were initially designed to apply to cross-border transactions, two instruments are particularly worth mentioning. First, the *United Nations Convention on Contracts for the International Sale of Goods, 1980* (CISG), provides a modern and balanced set of rules for sales transactions and is often used as a model for domestic and regional contract law reform as well as a source of inspiration for contractual provisions in specific business sectors. Second, the *UNIDROIT Principles of International Commercial Contracts, 2010* (the UNIDROIT Principles or UPICC), which represent a private codification or "restatement" of general contract law, have been widely recognised as providing balanced rules for contractual relations –

with special attention to the weaker party while also preserving the contract's economic purpose – and neutral solutions compatible with most domestic legal systems. When found appropriate for a particular relationship and subject to the applicable mandatory rules, the CISG and the UNIDROIT Principles can be used by the parties in drafting their contract (for example through the incorporation of selected rules as contract terms), or they may provide a useful reference for third parties involved in dispute settlement.

C. Contracts with an international element

33. Although rare, agricultural production contracts may sometimes involve an international element (for instance, when the contractor's place of business is situated in a different country than that of the producer). This situation may be found under multiparty contracts, involving for example an importer, a producer organisation and its members. In addition, the contract's international character arises from the fact that the goods are to be delivered by the producer directly in a foreign country. This section first examines the case where an international element relates to the obligations under the contract, and then briefly touches upon international non-contractual liability.

1. Contractual obligations

34. In most countries, the parties to an international contract are free to choose the governing law and the competent jurisdiction or dispute settlement mechanism. By agreeing to be bound by the law of a particular State, the parties subject themselves to all relevant laws or regulations that would govern their contract in that jurisdiction.

35. When an agricultural production contract is international in character, the parties commonly choose the law of the State where production takes place as the law applicable to the contract. One reason for this choice is to make clear to producers that their domestic legal regime applies to the contract, which is normally one of their expectations because it is best known to them. This choice thus facilitates contract compliance and enforcement. It is also possible that the choice of a foreign law to govern the contract may be prohibited by mandatory rules, which may be the case when special legislation on agricultural production contracts has been enacted in the producer's State or when the applicable rules of private international law place limitations on the choice of the governing law. However, it may also happen that a

particular State with a special legislation governing contracts for the sale of agricultural products has made it mandatorily applicable when the goods are delivered in that State, whatever law is otherwise applicable to the contract. In such a situation, While mandatory provisions will bind the judge in the State having enacted them, their application by a judge in a foreign jurisdiction may not always be certain.

36. When a dispute is brought before a court, in the absence of a choice of law provision in the contract, a judge would have to determine which law applies. Under a straightforward determination, a judge seized in the producer's jurisdiction is likely to find that its domestic legal system applies to the situation which, based on various factors, is closely connected with the State of the forum. On the other hand, if a judge determines the applicable law based on conflict of law rules, it is likely that the law of the State where the producer is situated will still be applicable unless another State has the closest connection with the contract or the particular obligation considered.

37. In certain cases, a uniform legal regime may be applicable to the substance of the contractual obligations. This may occur when the States involved have adopted a common statute regarding contractual obligations or as a result of the application of the CISG, which has become the generally applicable regime for the international sale of goods in many countries. The CISG applies either when the criteria regarding contracting States are met, or as a result of a private international law determination. Even when a uniform regime applies, however, certain matters may still fall outside its scope. For example, the CISG does not govern the contract's validity or its effect on the property of the goods. Such issues must be settled under the applicable domestic law.

38. When a dispute relating to an international contract is settled by arbitration, there is typically more flexibility than in State court litigation for determining the law governing the substance of the dispute, depending on the applicable legislation and specific rules of the proceedings. Parties are generally entitled to choose rules of law as opposed to a particular State law and, in this context, one widely recognised instrument is the UNIDROIT Principles. The parties may also authorise an arbitrator or a mediator to settle the case on the basis of justice and fairness. This may provide an appropriate basis for solutions in cross-border production operations (for example when companies are

dealing with producers situated close to the border in a neighbouring country).

2. *Non-contractual obligations*

39. When the goods produced under an agricultural production contract are unfit for human or animal consumption and cause personal harm or damage, a plaintiff may ask for compensation. It is then necessary to determine who should be held liable and bear responsibility to compensate for the damage done. While many countries would apply their general rules on torts – or non-contractual liability – others have enacted special laws on general product liability or on food safety matters. Depending on the particular legislation, the grounds of liability (*e.g.* based on fault or strict liability), and the circumstances of the case, such legislation may attribute liability to the producer or another participant in the supply chain, in particular to the operator that has processed or put the product on the market. This legislation may also provide for the allocation of liability between various operators.

40. When an international element is involved (for example, when damage is suffered in a different country from the one where the product was made), a judge having jurisdiction will determine the law applicable to the substance of the case, generally based on a conflict of law analysis. It can be observed that special conflict of law rules applicable to product liability consider, as one condition for the application of a foreign law, whether the person alleged to be liable – typically the producer – could have reasonably foreseen that the product would be marketed in the country where the damage was suffered. Consequently, under such rules, the person alleged to be liable would not be subject to an unforeseeable law. Because obtaining effective compensation from a producer abroad may be difficult, public policy considerations may prevail, thereby leading to the imputation of liability on the operator that has put the product on the market.

II. The role of the regulatory environment

41. In addition to legislation governing their obligations and the elements of their agricultural production contract, parties will be subject to several laws and regulations that will influence the formation and implementation of their contract, particularly regarding technical specifications. This regulatory environment may act as an enabling

environment and be conducive towards long-term sustainability or act as a disincentive against contract farming due to unnecessarily burdensome or intrusive regulation. In most cases, these public regulatory instruments are aimed at protecting public goods, developing the agricultural sector and safeguarding rural populations. They might involve: regulatory protection of human rights in agriculture, encompassing civil and political rights, as well as economic, social and cultural rights (such as the right to food, the right to health, the right to social security and the right to work); the protection of human, animal and plant health and the environment; labour law and decent rural employment in agriculture; laws governing access to natural resources necessary for agricultural production; and access to agricultural inputs and trade in agricultural products. This section presents a non-exhaustive list of these regulatory areas that may particularly influence the formation and implementation of agricultural production contracts. It refers to regulatory instruments adopted by countries both at the international and domestic level.

A. Agri-food trade

42. Contract farming directly intersects with matters governed by laws on the production and trade of agricultural products and with the sanitary measures and technical requirements that countries are entitled to set up, internally and internationally, in the context of trade liberalisation.

43. International trade law, largely made up by the international agreements underpinning the World Trade Organization (WTO), shapes domestic policies and legislation concerning the support and governance of the agricultural sector. Legal commitments made by countries at the multilateral level typically have to be implemented through reforms to domestic law and institutional or administrative structures. A good example of this type of multilateral commitment in the agricultural sector is Article 27(3)(b) of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), which makes it mandatory for WTO members to: provide for a system of plant variety protection; carry out export subsidy reduction commitments expressed by Article 9 of the WTO Agreement on Agriculture; and fulfil the requirement that agricultural marketing boards, generally falling under the definition of "state trading enterprises" stated in Article XVII of the

General Agreement on Tariffs and Trade 1994, carry out their purchases (for example of agricultural inputs) in a non-discriminatory manner.²

44. In particular, the WTO Agreement on Agriculture contains measures that Parties to the agreement must implement, concerning agricultural market access, domestic support, and export subsidies. Moreover, TRIPS calls on all WTO members to provide "effective and adequate" intellectual property rights (IPRs) that do not themselves amount to trade restrictions. The Agreements on Sanitary and Phytosanitary Measures (SPS) and Technical Barriers to Trade (TBT) influence domestic food safety and quality, and animal and plant health regulations. They also affect other technical requirements (such as certification, labelling and standardisation), that apply to agricultural products both domestically and in international trade.

45. Food safety and quality are becoming more important as consumer health protections are enforced under domestic legislation. The term "food safety legislation" refers to all legislation that addresses or is aimed at ensuring "that food will not cause harm to the consumer when it is prepared and/or eaten according to its intended use." The SPS Agreement, moreover, calls on Parties to align their food safety measures to the standards approved by the Codex Alimentarius Commission, which develops harmonised international food standards. Those standards apply to different levels of production and elaboration of agricultural products and may also treat different aspects highly relevant in the context of agricultural production contracts, including packaging and labelling requirements. Identification, monitoring and documentation of the different stages provide traceability of the product, which is increasingly required throughout the supply chain, from the producer to the final consumer.

46. Along the same lines, livestock production is governed by animal health and production legislation. WTO countries are encouraged to base their domestic veterinary legislation on the international reference standards adopted by the World Organization for Animal Health (OIE). In the absence of domestic legislation, contractors could request that producers incorporate farming practices recommended by the OIE (such as animal welfare standards), to facilitate access to international markets.

² More information about the WTO, including the text of the agreements mentioned, is available on the WTO's website at <http://www.wto.org/>.

47. Plant protection standards and international certification of plant health are governed by the standards approved under the auspices of the International Plant Protection Convention (IPPC). The IPPC is a legally binding international agreement that guides countries in the establishment of international and domestic phytosanitary measures and certification procedures, and serves as a reference for all operations involving international trade of plants and plant products.

48. Finally, countries may have enacted domestic legislation governing conformity assessment procedures, including certification services (see Chapter 3 at paras. 60-61). In the context of the TBT Agreement, these procedures are defined as technical procedures confirming that products fulfil the requirements laid down in regulations and standards. The procedures requested by domestic legislation can become effective tools of domestic protectionism and create "unnecessary obstacles to international trade", when applied in a non-transparent and discriminatory manner. To prevent these risks, Article 5 of the TBT Agreement establishes a set of substantive and procedural requirements governing this type of procedure, and encourages countries to foster conformity assessment procedures based on internationally recognised standards.

B. Production inputs

49. Beyond trade-related measures, agricultural production is commonly governed at the domestic level by a broad range of legal instruments aimed at regulating various agricultural inputs and ensuring that agricultural products meet the quality and safety levels expected by domestic consumers and trade partners. Legislation governing agricultural inputs affects the manner in which contract farming is carried out because it frequently entails adherence to prescribed production methods, as well as the direct provision of agricultural inputs. Those inputs might be regulated by input-based legislation such as seed and pesticide laws, legislation governing the protection of intellectual property rights over specific inputs or community rights to access protected inputs, or in commodity-specific acts that aim to regulate closely production and the supply chain for those commodities that are deemed particularly important for the national interest.

1. Seeds

50. Contractual arrangements for access to and use of seeds may be restricted by seed legislation, which ensures that seeds, as a critical asset for increasing agricultural production and productivity, are of a high quality and remain available and accessible to producers. In some countries, seed legislation recognises certified seeds as the only quality-guaranteed ones that can be legally marketed. In those countries, seed producers must enrol in formal certification schemes that are recognised through certified seed labels issued by the competent authority. Other countries rely only on the information included on seed labels. Obligations under the contract might restrict seed purchases to legally marketed seeds or specified seeds, but it is important to note that both producers and contractors are bound, where it exists, by domestic seed legislation.

2. Biosafety

51. Access to seeds and seedlings might also depend on domestic legislation governing biosafety. For example, certain countries have banned the import of genetically modified seeds, based on a concern that they may have adverse effects on the conservation and sustainable use of biodiversity, and may pose risks to human health. To regulate the international trade of such seeds, within the more general category of living modified organisms (LMOs), 130 Governments reached an agreement, referred to as the *Cartagena Protocol on Biosafety*, in January 2000. The objective of this Protocol is to ensure that the transfer, handling and use of LMOs resulting from modern biotechnology do not have adverse effects on the environment and human health, specifically focusing on cross-border movements of LMOs intended for release into the environment. The key point is that the Article 10(6) of the Protocol allows countries to prevent imports of genetically modified seeds even in the absence of conclusive scientific evidence of their harmfulness, thus embodying the precautionary principle.

3. Plant Variety Protection

52. Access to specific plant varieties, including seeds and seedlings, may be subject not only to seed legislation, but also to legislation governing intellectual property rights over plant varieties. Countries regulate the registration and legal protection of new plant varieties to

encourage commercial plant breeders to invest the resources, labour and time needed to improve existing plant varieties, in part by ensuring that breeders receive adequate remuneration when they market the propagating material of those improved varieties. Article 27.3(b) of the TRIPS Agreement requires WTO members to protect plant varieties using either: (a) patent law, (b) an effective *sui generis* (unique or of its own kind) system or (c) a combination of elements from both systems. Following this provision, some countries have adopted agreements promulgated under the auspices of the International Union for the Protection of New Varieties of Plants (UPOV). The UPOV treaties establish a *sui generis* protection system tailored to plant breeders' needs. Article 15(2) of the UPOV Act of 1991 incorporates the exception of "farmers' privilege," which allows the producer to use the product of the harvest from its own holding. However, the scope of the farmers' privilege varies widely in domestic plant variety protection laws. While some countries only permit producers to plant seeds saved from prior purchases on their own land holdings, others also allow them to sell limited quantities of seeds for reproductive purposes. Countries that are not signatory members of the UPOV Convention may choose to approve a different *sui generis* system or to apply general patent law.

4. Producers' right to genetic resources

53. Obligations under an agricultural production contract may be influenced by the producers' rights protections found in the *International Treaty on Plant Genetic Resources for Food and Agriculture* (ITPGRFA), adopted under the auspices of the FAO in 2001. This treaty aims to facilitate the exchange of seeds and other germplasm to be used for research, breeding and crop development. The treaty promotes this exchange by establishing a "multilateral system" to which member States and their nationals will be given "facilitated access." The ITPGRFA recognises the enormous contribution of producers to the diversity of crops that feed the world. It establishes a global system to provide producers, plant breeders and scientists with access to plant genetic materials and to ensure that recipients share benefits derived from the use of these genetic materials with the countries where those materials originated.

5. Other agricultural inputs

54. In addition, laws governing access to and use of pesticides and fertilisers may also influence the obligations contained in an agricultural production contract (see Chapter 3 at para. 112). Legislation on pesticides and fertilisers normally includes a general prohibition against producing, purchasing and using products that are not authorised or registered by the competent authorities. Producers are bound to use authorised products and to respect rules related to their use and disposal. In the realm of livestock production, parties will also need to pay attention to legislation governing feed, veterinary pharmaceuticals, and livestock rearing and welfare.

C. Agricultural finance and support

55. To varying degrees, Governments around the world have implemented policies and enacted legislation designed to support their domestic agricultural sectors, resulting in more or less stability depending on any uncertainty in the policy changes. Such Government efforts may have a range of effects on the content and formation of agricultural production contracts, from the availability of third-party credit to the contractor's ability to rely on Government-supported extension services to improve producer capacities. These efforts may be very broad or may focus on one or several commodities deemed to be particularly important. For example, regions that have relative advantages in certain agricultural products may be designated and zoned as stable large-field production areas with intensive support by the Government, both in technology and investments for such products. Alternatively, policies could also be promoted to support contract farming activities for producers and entrepreneurs who are not eligible for or do not participate in large-field production zones.

D. Competition and antitrust

56. Contract farming may be strongly influenced by competition law as, in many legal systems, unfair contractual terms and practices are addressed and sanctioned under mandatory rules in unfair competition and antitrust legislation. This type of legislation aims to correct market distortions or constraints resulting from the abuse of dominant positions by one or several participants. Market distortions occur when a small number of operators control a particular market and enter into

agreements or concerted practices aimed at determining or influencing prices, production quotas or products, or sharing sources of supply and thereby restraining commerce. Due to the size and market importance of some parties, the producers might have to accept unfair terms as they would not be in the position to reject the contract or negotiate better terms. Unfair practices may also involve undue preferential or discriminatory treatment of particular producers or categories of producers through contractual conditions, by imposing different treatment upon similar parties and more generally by using deceptive practices. In some cases, exclusivity clauses (See Chapter 3 at paras. 18-21) might also raise antitrust issues when they unduly restrict competition.

57. Antitrust legislation may apply as a matter of general economic public policy, and can be intended in certain circumstances for particular sectors (such as the food and feed processing industry), and even a specific commodity within such sectors. Through antitrust regulation, anticompetitive behaviours, unfair and fraudulent practices, and particular contract terms or practices defined as unfair or unreasonable may be prohibited or sanctioned.

E. Human rights

58. International human rights obligations influence how Governments regulate contract farming, and may also affect the way in which the parties structure and carry out their agreement. Businesses have a responsibility to respect human rights that exists independently of the States' ability or willingness to fulfil their own human rights obligations. Governments could view the opportunities offered by contract farming arrangements as a practical tool through which to achieve social objectives. From a human rights-based perspective, there are several principles that should be incorporated into the negotiation and implementation of agricultural production contracts. Participation, accountability, empowerment, non-discrimination, transparency, human dignity and the rule of law are some of the principles that business models such as contract farming should encompass. Participation, empowerment and non-discrimination are particularly important for fostering the role of vulnerable parties, particularly women in the negotiation and signature of such contracts (see Chapter 2 at para. 56). Although women are the predominant producers of some commodities, they are often excluded from decision-making and, in most cases, yield to men for contract signature. Women's role in agriculture should be

fully recognised and supported by governments by promoting and facilitating their access to negotiation and decision-making platforms, agricultural inputs and income-generating opportunities such as contract farming agreements. Contract farming has the potential to improve the livelihoods of small rural farmers by facilitating their access to markets and by creating opportunities for decent work and income generation. Increased stability and the farmers' ability to forecast their own livelihood may create, in turn, the potential of improving overall human and environmental rights protection.

59. Among the human rights that are closely linked to contract farming, one of the most central is the right to food. After its first international expression in the *Universal Declaration of Human Rights* in 1948, the right to food has been recognised in several international legal instruments as well as in domestic constitutions and laws. The *International Covenant on Economic, Social and Cultural Rights* (ICESCR), a binding legal instrument to which 162 countries are parties as of September 2014, deals with this right more comprehensively than any other instrument. The UN Committee on Economic, Social and Cultural Rights, in its General Comment 12, has further explained that the core normative content of the right to adequate food includes: (a) the availability of food in a quantity and quality sufficient to satisfy the dietary needs of individuals, free from adverse substances, and acceptable within a given culture; and (b) the accessibility of such food in ways that are sustainable and that do not interfere with the enjoyment of other human rights. Contract farming's impact on the realisation of the right to food, as well as the impact of the right to food on contract farming, will indirectly depend on how Governments incorporate their international human rights obligations into their domestic policies and regulatory frameworks and directly depend on how contractors and producers include clauses conforming with the right to food in their contracts. As mentioned earlier, businesses have their own independent responsibility to respect human rights, and this should be reflected in the best contractual practices implemented in the field.

F. Labour law

60. Labour law is another area of domestic legislation that is closely linked to contract farming. Labour law provisions may play an important role if producers recruit workers to assist them in producing the quantities and qualities specified in the agricultural production contract. In such cases, producers will need to apply domestic labour legislation

touching upon agricultural production, including the implementation of labour law provisions governing the relationship with their employees. It is important to remember that, as producers often recruit workers to assist them in production under an agricultural production contract, such workers may fall under the producer's responsibility.

61. Additionally, labour law may have an impact on contract farming operations in cases that cross the line into a labour relationship, as determined by domestic legislation (see Introduction at paras. 43-46). However, the essence of contract farming is that the producer acts under the contractor's guidance as an independent party, not an employee. Thus, if producers and contractors are involved in an employment relationship, they cannot be considered to have concluded an agricultural production contract within the Guide's scope. Nonetheless, a labour relationship's boundaries may be difficult to draw in particular situations.

G. Access to natural resources

62. Depending on the region and type of commodity, contract farming may touch upon issues of access to land, water, forest resources, or wild products. For many agricultural production contracts, the land's accessibility is the most necessary component for production. Many different questions may arise depending on the nature of rights held over the land – ownership or otherwise – and the identity of their holder, in particular whether it is one of the parties to the agricultural production contract or a third party, including the Government. Especially for contractors that engage in contract farming with indigenous producers, the concept of Free, Prior and Informed Consent (FPIC) is very important. FPIC is the “collective right of indigenous peoples to make decisions through their own freely chosen representatives and customary or other institutions and to give or withhold their consent prior to the approval by Government, industry or other outside party of any project that may affect the lands, territories and resources that they customarily own, occupy or otherwise use.”

63. Ownership and other forms of control may entail several obligations under public regulations. Public land management can impose restrictions on the kind of commodity that may be grown or raised, in addition to environmental requirements. On the other hand, several issues may arise in connection with the characterisation of land rights under the applicable law. For example, tenancy agreements may

be a regulated type of contract under different legal systems. Land access and tenure are frequently regulated by specific domestic land access legislation, whether included in civil codes, agrarian codes or stand-alone statutes. While land legislation may regulate access to real estate rights affecting agricultural land, countries may also regulate access to other natural resources that are fundamental for agricultural development, including water resources, forests, and fisheries.

CHAPTER 2 – PARTIES, FORMATION AND FORM

1. This Chapter explores the formation of an agricultural production contract, as well as the parties to the contract. Part I introduces the range of parties that may be involved in an agricultural production contract. Part II provides an overview of contract formation, including the key elements of offer, acceptance and confirmation. Part III discusses the form and content of an agricultural production contract.

I. Parties to the Contract

2. The agricultural production contract covered by the Guide (see Introduction at paras. 35-36) typically involves a producer and a contractor engaged in a bilateral relationship, but sometimes other entities may participate in the arrangement, creating a multiparty contract. In other situations, third-party entities could deal with one of the parties based on a separate but linked contract that is instrumental to the performance of the central agricultural production contract. Sections A and B identify the two key parties that undertake the characteristic obligations under this type of contract (*i.e.* an agricultural producer and a contractor). Section C provides an overview of other parties who may participate in the contract, have an interest in it or otherwise influence its conclusion and performance.

3. For a better understanding of the present analysis, it is important to bear in mind the intersection between agricultural production contracts and domestic legislation. Thus, the way in which a contracting party is qualified under domestic law (as an individual or a collective entity) has important consequences for the legal regime that will apply to it and to its dealings with third parties. Indeed, in countries that have enacted special legislation for agricultural production contracts (see Chapter 1 at paras. 7-10), the nature of the parties serves as one element defining the scope of this contract type. The concepts of agricultural producer and contractor presented below refer to the economic and legal position under an agricultural production contract, but not to the status that may be recognised under domestic laws or regulations for special purposes, such as subsidies or licences.

4. It should also be borne in mind that domestic law governs issues regarding the capacity of natural and legal persons to conduct economic activities and to enter into a contract. The form and legal structure of each party will further determine its obligations under tax or corporate law, which are not addressed here. It may, however, be noted that agricultural production contracts sometimes contain clauses in which the producer, the contractor or both represent to have duly complied with such duties, assuming full responsibility for the consequences of noncompliance.

A. The agricultural producer

5. An agricultural producer may be defined in various ways and, even within a given country, particular laws and regulations may apply different criteria depending on their context or purpose. This is notably the case in important areas (such as land tenure and management, eligibility for financial subsidies, applicable tax regimes, social security schemes, possible special status under competition law, as well as environmental, health and hygiene regulations). However, two criteria in particular are generally relevant to characterise an agricultural producer, namely the nature of the produced goods and the activity itself.

1. Distinctive features

6. Depending on the country, the concept of “agriculture” may relate to the utilisation of land, forest, marine and freshwater resources. Very often it refers to obtaining primary products from identified sectors, typically crop cultivation (including specialisations such as horticulture, floriculture, viticulture), animal husbandry, forestry and aquaculture, as well as products directly derived from these activities (such as milk, honey, and silk). In many countries, an analytical approach focuses on control of a “biological cycle,” a concept referring to one or several operations carried out with a view to the biological development of vegetal and animal products.

7. Another criterion which is generally used to qualify an agricultural producer under domestic law assumes that the producer, whatever its size and structure, carries out the production on an independent and professional basis, whether individually or part of a group. As mentioned in the Introduction at para. 43, employees fall outside of this definition and are therefore not within the Guide’s scope. The professional purpose of the activity may be defined in various manners. First, it may refer to

the producer as an “entrepreneur,” or to its undertaking as an “enterprise,” which implies an organised activity involving a level of financial risk. Second, there may be reference to the activity’s economic purpose as including the sale of products or an exchange of goods and services. Lastly, definitions may exclude production intended exclusively for family or household consumption.

8. An agricultural activity typically takes place over a certain portion of land or in installations that are under the producer’s control and management. This control may involve actual ownership or rights of use, together with related rights under the domestic law. The producer may also lease the land from a private or public entity. In many jurisdictions (and in developing countries in particular), individuals or communities often live on land without holding any formal title, under traditional or customary forms of tenure. Whatever their nature, the possibility for a producer to rely on secure tenure rights will enable it to engage safely in a production activity and to contract on a sound basis.

2. Legal status

9. Domestic laws may apply different rules to agricultural producers depending on the nature of their activity or their legal status, generally affording greater legal protection when producers are not engaged in commercial activities. The basis for protection depends on the legal system and the particular country.

10. Many countries distinguish between a “civil” and a “commercial” body of law, and regulate most aspects of the status and activity of producers under the general rules of the “civil” law. However, when producers act under certain corporate structures, “commercial” rules would apply. Agricultural producers subject to civil rules would be entitled to process or market their products only as ancillary to production activities. Besides fiscal benefits, a “civil” status would involve the application of special rules in matters such as agricultural land leases, insolvency or court jurisdiction. The extent to which that party is considered to be a merchant or a professional, or falls short of that status, will determine whether the general part of the law of obligations will apply rather than special commercial law rules governing transactions among merchants.

11. In many other jurisdictions, the status of agricultural producer would not be subject to a particular body of law as distinct from other activities. Rather, a distinction would be drawn between: (a) a person

occasionally involved in dealing with agricultural products and having no or limited experience or knowledge regarding the particular commodity sold or market concerned, and (b) a producer acting on a commercial basis, having knowledge or skills with regard to certain practices or goods, or an experienced professional involved in transactions in the ordinary course of its business. If the producer is characterised as a “merchant” or an agricultural firm, rules applicable to commercial activities will govern contract formation, performance and remedies. For example, a merchant will generally be subject to default obligations regarding the quality of the goods delivered under a sale. In addition, subject to special regulation, it may not be required to comply with applicable written form requirements for enforceable agreements. Furthermore, merchants may not benefit from the extended protection granted to non-commercial parties by special legislation on unfair terms and practices or statutes of fraud.

3. Forms for conducting an agricultural production activity

12. Producers may carry out their activity on an individual or collective basis. As agriculture develops as an income-earning and profit-making activity, the ways in which producers organise themselves are increasingly captured by legal formality. Institutional forms and legal structures may be the same that are available for other sectors or activities, but in most countries, there are legal forms specifically designed for agricultural producers. Each particular form entails a range of different rights and obligations and, from a business perspective, may have a decisive influence on the activity’s management and potential development. For the purpose of this Chapter, the common legal forms that producers may take will be classified into two broad categories, depending on whether they represent a legal structure for exploiting a single undertaking or whether they are used as a pool of several undertakings.

(a) Individual producers

13. Around the world, the agricultural sector is often made up of small to medium-sized entities, most being family-managed undertakings. Accordingly, while encouraging the development of large entities to respond to increased productivity needs, many countries also implement public policies to sustain small and medium scale rural enterprises. Particular attention is paid to small and micro enterprises and to empowering specific categories of persons, such as women or young

entrepreneurs. Available policy options in this realm include simplifying and reducing the costs of the formalities required to open and operate an enterprise, thus encouraging producers to acquire a formal status either as individual entrepreneurs or under a corporate form.

(i) Natural persons and partnerships

14. Individual producers generally operate through small production structures in terms of capital size, number of workers employed and volumes of production. In most parts of the world, farming businesses are not required to incorporate under a specific legal form. However, registration is often required to obtain permits, licenses or public certifications needed for certain types of production. Registration comes with certain obligations (such as tax and accounting liabilities) but also affords a certain level of protection, typically by giving access to social security benefits and public programmes geared toward the formal sector. Some countries where the informal sector prevails have thus implemented simple registration procedures providing a certain level of legal recognition that may facilitate access to credit by formal banking institutions and to other forms of State support.

15. In an agricultural undertaking owned and operated by one individual, the personal and professional capacity and assets form one single entity, to which the creditors may have access to secure payment of the debts contracted for the agricultural production. The producer, as well as the producer's family, may be exposed to substantial risks. Depending on the applicable law, however, certain items of the household property, or the land itself, may be protected from attachment in debt recovery proceedings. Furthermore, in addition to the risks inherent in agricultural activity (such as weather constraints), an undertaking operated by an individual is exposed to risks related to the owner's physical condition and well-being.

16. Often, two or more individual producers join their capital and skills to carry out a revenue generating activity, appearing as a single entity but having no separate legal personality. Many such situations may arise in practice (for example within a family or a group of neighbours). This type of undertaking, recognised as a partnership under most legal systems, would be considered as jointly held by the partners. Absent a specific agreement, partners would share profits and losses equally, each incurring joint and several liability for the other's decisions, debts and defaults. This feature may entail risks, but would also have a peer

monitoring effect within the group. Certain forms may allow members to participate with a limited liability.

17. While not legally required, a written agreement is generally useful to govern the relations between the partners regarding matters such as capital contributions, allocation of profits and losses, duties and management responsibilities. A written agreement brings the added benefit of clarity from the contractor's perspective, in particular regarding the status of the person authorised to contract and deal on behalf of the group.

(ii) Corporate structures

18. Corporate structures are particularly suitable for collective holding of capital and represent widespread forms of farming. Smaller groups of investors may prefer simple corporate structures (such as the limited liability company). In many countries, individual producers also have the option to incorporate as a single-owner company. Under a corporate form, the activity's continuity can be facilitated by the transfer of company shares (for example upon a shareholder's death). Setting up a company creates an independent legal entity, thus separating the owners' personal assets (typically the land) from the company's assets and limiting the owners' liability for the company's debts. It must be noted, however, that incorporating as a limited liability company would not shield the producer against all liability. Creditors often seek to obtain a personal guarantee for the debts or other obligations under the contract (for example by obtaining a bill of exchange signed by the producer, or a mortgage over non-farm assets), when this is allowed under domestic law.

19. Many countries have special corporate structures for small undertakings with a limited number of producers (for example up to ten members, typically relatives, family members or neighbours) either personally and directly involved in the production by providing labour in addition to capital, or also admitting other non-producer physical persons. These special types of producer organisations may be limited in their ability to carry out activities considered to be of a "commercial" nature (such as trading or processing the product) except within certain limits. Limitations of this nature may be one of the reasons why contract farming arrangements are a suitable vehicle for agricultural product distribution and the better integration of producers into supply chains.

(b) Producer organisations

20. Agricultural producers may also join the resources of their respective production units, even without losing their individual autonomy, by creating producer organisations (such as associations or cooperatives). In the context of the Guide, the concept of producer organisations is intended broadly to include any form where the production of individual producers is managed or marketed collectively. Among the available forms, associations and cooperatives may be seen as the most widespread categories of organisations that could participate as a party in a production relationship, although a large number of different designations and forms may also be found in practice and under national law.

21. When producers join efforts under an adequate legal form provided by the law, they are able, as a group, to seek commercial financing, conclude insurance contracts, hire labour, apply for public subsidies or other public policy programmes, develop certification schemes, own shares in other legal entities, and take various other steps to build, strengthen and increase production capacity. An organisation with legal personality can buy, hold and sell immovable or movable property, be a party to a contract and act in legal proceedings.

22. The legal formalisation of a producer organisation generally requires a certain level of group maturity in terms of internal cohesion, minimum technical and financial capacities and management, and awareness regarding the objectives and means to be implemented. This, in turn, may result in strong interdependence and an added social pressure encouraging all members to implement best practices. Also, the formation and operation of a legal entity have implications in terms of costs and liabilities. Certain countries have therefore adopted simple legal forms intended for groups with small-scale producer membership that would allow them to engage in formal dealings with buyers. Special programmes and policies are implemented both by public actors and by non-Governmental organisations to foster and sustain small producer organisations. It is also worth noting that several private sector participants dealing with such organisations, especially under Fair Trade or Equitable Trade schemes, have focused on the empowerment of small producers by undertaking specific obligations in their contractual relationships (for example by providing extension services and support to the community).

23. Members of traditional communities or indigenous groups may produce collectively and deliver products to contractors under

agricultural production contracts. Certain countries recognise by statute a legal personality to designated customary bodies or traditional communities. A community could function as a producer organisation, with members having their own assets and the head of the community being authorised to enter into contracts for the community, or members could also have common ownership over the community property. Most often, there would be no written documents evidencing title or relations within the community, but there would be a general knowledge inside it about title or identification of the community or its members. Often, people dealing with the community (such as contractors) may also possess this knowledge. Nevertheless, a written association agreement would also be preferable in this context.

24. Different types of organisations may also have an important advocacy role. Under the generally recognised principle of freedom of association, contractors should not restrict a producer's right to join or contract with a producer association. Similarly, contractors should not engage in retaliatory or discriminatory practices towards producers exerting such rights. This type of conduct would often be sanctioned under domestic law and is expressly condemned as an unfair practice under specific legislation governing agricultural production contracts. Under such laws, the protection afforded to producers to join an association is further strengthened by the prohibition against insertion of confidentiality clauses in contracts and their consequent invalidity.

25. Producers may also join informally, without registering or complying with formal requirements provided by the law or without formally defining the relationships between members and how they will be represented. This may result in a high level of uncertainty when one person deals with a contractor on behalf of a group of producers. This may be the case when one leading producer aggregates the production of its neighbours, delivers the inputs supplied by the contractor, and then makes payment to the other producers. Whether the leading producer acts on behalf of the group as a single entity or on behalf of each of the individual producers needs to be clarified in advance because a default by one member will have different implications. In certain situations, the person acting on behalf of the group could be personally responsible for defaults by group members. Usages within the group and implied authority will be relevant in this context.

(i) Non-profit entities

26. Agricultural non-profit entities may play a role in enhancing their members' capacities in information, management, training and extension services, research, advocacy and other areas. They may also provide services for the organisation of production by receiving and distributing inputs, performing land preparation services, and monitoring contract performance through quality control. They may act as facilitators in dealings between producers and the contractor and sometimes also toward other parties (such as a bank providing credit to producers, or a Government entity administering a public development scheme). Depending on their particular form, entities in this category may come close to a cooperative. However, because of their non-profit identity and purpose, voluntary associations, self-help groups and similar entities are not authorised to distribute profits to members. It should be noted that, in several countries, non-profit entities are entitled to conduct revenue-generating activities under certain conditions, while in others this capacity is restricted.

27. The relations between the entity and its members and the operating rules are set by its internal statutes, while the legal capacity of the association and scope of liability towards third parties are determined by domestic law. The authority of a legal representative to deal with third parties and undertake obligations on behalf of members is based on the authority conferred by the members under the statutes. Sometimes, it is also reflected in the agricultural production contract itself. The association may be a party to an agricultural production contract, undertaking specific obligations in its own name as a facilitator, in addition to acting as an agent regarding members' obligations toward the contractor.

(ii) Cooperatives

28. Cooperatives are economic entities that, depending on the relevant legal system, may combine commercial and not-for-profit features, and play a major role in the economic and rural development of many countries around the world. In certain geographical areas and for particular commodities, agricultural cooperatives gather very large numbers of producers and manage most of the production. They may, however, take several forms depending on their membership, object and activities. Cooperatives may vary considerably in size as well as in technical and economic capacities.

29. An agricultural cooperative may perform different tasks. It may market the production of its members or even organise the production process itself. Moreover, cooperatives sometimes provide services (such as planning, technical assistance, access to equipment, supply of inputs, and quality control). As the cooperative acquires more business and financial strength, activities and services to members could expand to include, for example, group certification or obtaining third-party certification, developing specialised products and labels, and engaging in downstream activities (such as pre-processing, transformation and packaging). These activities may often be undertaken through commercial subsidiaries (vertical integration) or based on contract alliances and networks (horizontal integration). Cooperatives may also gather associations of producers rather than just individual ones.

30. In many countries, cooperatives are regulated by a special legal regime, and particular rules may apply to those engaged in agriculture or the production of specific commodities. In other countries, cooperatives come under the general rules governing corporate bodies, sometimes adapted in light of cooperative principles. Internal statutes regulate the relationship between the cooperative and its members based on their participation as financial shareholders and primary (and sometimes exclusive) beneficiaries or users. Based on this duality, in certain countries the relationship between members and the cooperative is viewed as *sui generis* in nature, and cooperative rules would apply to certain issues (such as transfer of ownership, price, duration of the contract, and remedies for non-performance).

31. The parties involved may assume different roles, obligations and risk allocations, depending on the purpose and membership reflected in the cooperative's statute and its business strategy for dealing with produce buyers. When the cooperative gathers producing members together (for example on jointly owned or controlled agricultural plots), the cooperative will enter into an agricultural production contract in its own name. In this situation, it would be directly responsible for the obligations toward the contractor and non-compliance by individual members would be dealt with internally under the cooperative's rules.

32. Members producing individually or grouped under associations may join in a cooperative for marketing or exporting their produce. The cooperative's role and liabilities would vary depending on its statutes and the applicable law and whether it acquires title to the produce from the members or acts as their agent. In the latter case, the acts validly entered

into by the cooperative as an agent bind directly the members under an agricultural production contract, while the cooperative will respond directly for the acts performed in its own name. On the other hand, when the cooperative acquires title over the produce delivered by its members in order to resell or process it, the services provided by the cooperative to members often correspond to those typically delivered by a contractor under an agricultural production contract. However, it is important to note that a commercial firm buying the produce may also provide direct services to producers, conceptually bypassing the cooperative. In such a case, the various possible participants (producers, associations, cooperatives, or commercial buyers) would share obligations and responsibilities in the manner spelled out in the relevant contracts.

B. The contractor

33. For purposes of the Guide, the contractor is the party commissioning the production from the producer and providing a certain degree of guidance (such as the supply of inputs, services, finance and control over the production process). Typically, the contractor will be an entity that manufactures or processes the produce, and then sells it either to the final consumer (as increasingly occurs with supermarket brands) or to other chain participants for further processing and onward sale along the supply chain. Particular types of transactions where the final consumer (either individually or collectively through a cooperative for example) deals directly with agricultural producers are not within the Guide's scope. The contractor could also be a wholesaler or an exporter. Besides commercial entities, other types of contractors may be involved (such as cooperatives and, occasionally, public entities). In countries where certain commodities are publicly regulated and cannot be traded directly between private parties, special exemptions may allow producers to enter into contracts with commercial contractors.

34. The contractor's legal form will be relevant in several different ways. It may determine the rules applicable to its relationship with the producer, as a possible definitional element of a type of contract regulated by certain domestic laws. Its capacity will generally have an influence on the characteristics and balance of its contracts with agricultural producers.

1. Private corporate structures

35. The contractor will often be a business entity, carrying out its activities on a commercial basis. Some laws dealing with agricultural production contracts define this type of contract in part by referring to this commercial status, designating the contractor as a “processor,” “industrial” party, or “agribusiness.” Such laws may require its incorporation under a particular form characterised as a “commercial” entity. Under some laws, a contractor entering into an agricultural production contract may be designated as an integrator, a buyer, a financier or some other term.

36. Contractors may vary widely in size, business format, and ownership. They may be small businesses dealing with limited numbers of producers and supplying buyers in the local market, but often they could also be entities conducting large-scale operations for domestic or export markets. As food supply chains are highly concentrated and operate globally, the contractor would be part of a corporation or a group with an international reach. The relationships, strategies and bases for coordination between the single entities of the group may rely on various institutional forms and contractual structures. Very often, a transnational corporation would operate locally through a jointly owned company based on foreign and local capital shares, incorporated or registered in the country where the production takes place. The contractor may also be a foreign company operating directly from its main office situated abroad or operating through a local branch. In the latter case, the rules applicable to that entity may require close attention as they may vary from country to country.

37. Under a traditional format, the company would be totally owned and controlled by commercial investors. For certain entities, however, social concerns underpin business objectives, forming the basis of so-called social companies. Such a company would often be formed by a producer organisation developing activities down the supply chain in coordination with the production. In other cases, producer organisations would take a share in the capital of a company entering into a joint venture with other equity investors, possibly including public entities. The capital formation will influence the company’s strategy, operating methods and dealings with producers.

38. A cooperative may also act as a contractor under an agricultural production contract. As seen above, in many instances members would supply their produce and transfer title thereto to the cooperative on an

exclusive basis, while receiving various services. Depending on domestic law, relations between members and the cooperative would either be regulated by special cooperative law or general contract law subject to certain adaptations reflecting cooperative principles. When a cooperative deals with non-members, it would do so as a contractor based on general contract law or the applicable specific legislation.

2. Public entities

39. Public Government entities are seldom directly involved as a party to an agricultural production contract, but may instead be otherwise involved, for example in contract negotiation, as explored further in Section 2. at para 87 below. In some cases, however, a public entity could participate as a contractor in an agricultural production contract. Public entities are institutional buyers of agricultural products intended for schools, hospitals, the military or other needs in the public services context. International humanitarian agencies delivering food under emergency assistance programmes are also major purchasers of agricultural commodities. While most of this supply is obtained on spot markets where goods are available for immediate delivery, increasing attention is given in many countries to coordination with the production stage. On the one hand, this results from the general concern to keep a closer control over the products' quality, with the frequent requirement that producers be certified or supply certified products, and in certain contexts also that they be covered by product liability insurance. On the other hand, it serves as a basis for targeted policies in support of certain categories of producers (for example to provide stable markets under sustainable terms for local small producers or family farming).

40. In many cases, however, a public agency would contract with a private partner selected through the appropriate procurement procedures to deliver the service, including organising the procurement and supply in accordance with designated requirements. Under this formula, while the public entity would set the standards, it would not be directly involved in contracts with individual producers. They would be concluded by a private contractor, either a commercial company or a not-for-profit entity, delivering benefits for the community rather than solely pursuing a private interest.

41. In other situations, the relationship could be established directly between a public agency and the producer, thus potentially reducing transaction costs, as no intermediary is involved. Many countries apply

special rules to the procurement process, including competitive bidding proceedings to select the contracting party. However, informal direct contracting may also be possible for certain categories of products or purchases below certain amounts. In either case, particular requirements may apply, with implications notably on contract formation and price. The legal status and regime for such dealings would vary depending on the country. Usually, under common law systems, general contract law would remain applicable, except for special provisions provided by the relevant public regulations. Under civil law systems, the public entity may either be deemed to act in a private capacity, its contracts being private in nature and therefore governed by general contract law, or contracts may be seen as special acts governed entirely by public regulations or administrative law.

42. To facilitate contract farming's use, public authorities could adopt various methods without endangering the relationship's financial sustainability. For example, the Government could offer tax exemptions or subsidies to contractors contracting with smallholders. Similarly, facilitating access to information and implementing training workshops to enable decision-making and marketable skills for farmers could effectively increase contract farming's desirability.

C. Other parties

43. Beside the situation where certain entities act in representation of one of the parties (for example a producer organisation concluding a contract on behalf of individual producers), many parties other than the producer and the contractor may participate in the agricultural production contract, have an influence on it or be affected by the production relationship. These parties may be either supply chain participants or interested third parties.

1. Supply chain participants

44. Supply chain participants include all entities adding value to a final product along the supply chain, from its conception through production, transformation and handling, up to final consumption (for instance by providing goods, finance, services, information, and know-how), thereby contributing to the production process. Participants may be linked through institutional or contractual relations. The agricultural production contract contributes to the supply chain's operation with direct links to its

other structures and participants and is, in turn, subject to the influence and tensions exerted by those participants.

(a) *Linkages between participants*

45. The parties to an agricultural production contract may be linked to other supply chain participants in many ways. Under a multiparty contract, the other party or parties intervene directly in the production and each participant's role and level of responsibility will often be specified in the contract, together with the possible effects of one party's breach on the other parties' contractual relationships.

46. Other parties may be bound to the producer or contractor under separate arrangements, aimed at helping them perform their obligations under the agricultural production contract. This will be the case, for example, for workers hired by the producer or for providers of goods (for example seeds) or services (such as transport or harvesting) needed by the contractor to perform its obligations toward the producer. As employees, subcontractors or agents, each of these parties would, in principle, be responsible only toward its own contracting party.

47. In certain situations, however, a specific third party's intervention may be required or provided for by the agricultural production contract, making the contractual relationships interdependent. This could be the case when the contract requires the producer to purchase the inputs from a designated supplier, or when the producer is required to provide a personal guarantee to a third party to secure its obligations under the contract. In these cases, contractual relationships are linked, meaning that non-performance or defective performance under one contract may cause non-performance under the related contract (see Chapter 3).

48. Finally, the supply chains constitute their own special form of linkage between parties. In a supply chain, the participants share common interests and implement compliance mechanisms to protect them. If either party then fails to perform, the remedies would flow either from the contract itself or from the applicable legal system's mandatory provisions. A likely source of tension in the supply chain context lies in matching the coherent supply chain structure with the legal concepts and practical consequences of the different parties' autonomy and privity of the contract. Giving more importance to either would certainly affect the other, as greater coherence leaves less room for party autonomy and *vice versa*. However, certain legal systems may recognise the effects that certain obligations between the parties to the agricultural production

contract would have on third parties, based on extra-contractual liability, on the contract, or on legal doctrine (for example in third party beneficiary contracts).

(b) Types of participants

49. Various parties are or may be relevant to an agricultural production contract, depending on their particular situation and the local market's features. In highly integrated relationships, the contractor provides most of the goods and services required to carry out production, while in other circumstances, other participants will play a more active role. As global supply chains become increasingly consumer-driven, the requirements applied at the final consumer stage have a strong effect on the content of the various participants' obligations along the chain. At the international level, safety and quality standards or corporate social responsibility requirements in developed markets are often higher than those applied in countries where the production takes place, affecting in certain situations the availability of an alternative market for the product.

50. Except when the contractor produces and delivers the inputs to the producer, physical inputs (such as seeds and planting material, young animals and animal feed, and chemical and veterinary products) are purchased from third-party suppliers, generally on credit terms. The contractor may purchase the inputs for delivery to the producer, require the producer to purchase the inputs from a specific supplier, or impose no such requirements. In certain cases, inputs may be subject to third-party intellectual property rights (see Chapter 3 at paras. 93-102).

51. Service providers will often act as subcontractors for one of the parties. For example, the producer may subcontract with a third party which harvests the crop, or the contractor may subcontract with a third party to conduct site monitoring during the production process. This situation may also arise where the technology to be applied under a particular production process is protected by third-party intellectual property rights.

52. The agricultural production contract will often serve as a vehicle for producers and contractors to obtain credit or financing from microfinance institutions, commercial banks, social lending institutions, or Government entities under public schemes. Guarantee of payment may be built onto the contract, for example, if the producer receives advances from the credit institution against a lien over future revenues generated under the contract. The contractor would stand as a guarantor

toward the bank on the producer's behalf or, based on the producer's rights assignment to the bank's benefit, the contractor could make direct payments to the bank in discharge of the producer's debt. In other similar situations, the contractor could finance the production for the producer if the latter is unable to obtain credit or financing from institutions due to lack of formalities or documents. Certain agricultural production contracts would organise close monitoring of the parties' performance, linking the release of credit or loans to the producer (for example for the purchase of inputs), to notice by the contractor or other party intervening as facilitator. This type of situation occurs frequently when the agricultural production contract is part of a Government-sponsored development programme through which financial support provided either by a public or private banking institution is guaranteed by the Government.

53. Insurers may also be interested parties in agricultural production contracts. Insurance can play an important role mitigating many of the risks involved. It may cover many hazards (such as fire, theft, disease or natural calamities, damage to property or injury of third parties on the facilities), as well as the life or health of the main actors performing the contract. However, insurance coverage is not always available and when it is, premiums may be unaffordable for many producers, especially smallholders. In certain countries, it may be mandatory for the parties to take out a particular insurance coverage, and production contracts may also provide specific obligations in this regard (see Chapter 3 at paras. 165-168 below). Insurance products are typically provided by private entities. They may also be offered by large cooperative or mutual entities, or in the form micro-insurance, both of which can render insurance more affordable. Public policy schemes also exist in several countries, providing guarantee mechanisms to private insurance services or subsidising minimum insurance coverage, generally linking it to credit granted under public schemes. Beyond insurance schemes, large-scale natural calamities may be covered by special State interventions offering some level of compensation for agricultural losses.

54. Third-party verification provides the parties with an independent and expert assessment of the product's conformity at delivery (which may also apply to inputs delivered by the contractor) and, as the case may be, at critical stages of the production process. The contract may provide for this verification, and it may be carried out by a technical body offering the necessary guarantees of impartiality and skill. It may also be provided by public entities (such as commodity boards), non-

governmental entities or private entities. The parties may also decide to resort to third-party verification after a disagreement arises on product conformity.

55. Third-party verification may be based on certification schemes and particular sets of standards. While compliance with mandatory standards is monitored through public enforcement mechanisms, compliance with private voluntary standards relies on a certification contract with an accredited body. Sometimes, the contractor covers the costs of certification for the producer, to ensure that its production can bear the label corresponding to the standard against which it was successfully certified. Often, however, certification costs actually fall on the producer. The certification procedure is determined by each standard scheme and involves several controls taking place over periods of time (such as on-site inspections, taking samples for chemical or biological tests, auditing, and reviewing documents). When irregularities are found and standards have been infringed, the certification scheme generally provides for a series of measures that the certifying body is entitled to apply (from corrective instructions to sanctions leading potentially to a denial or withdrawal of the certification). When dealing with contractor's remedies under the agricultural production contract, an appropriate alignment or coordination with the enforcement mechanisms provided by the certification scheme will be necessary.

56. Extension services generally aim to strengthen producers' capacities by supporting the creation and operation of producer organisations, the development of agronomic and management skills, or access to information on market conditions. Those services may also include facilitating relations with contractors by helping to identify potential parties, and to negotiate and draft the contract. During the production, extension services may support better compliance and provide assistance when disagreements arise between the parties. Extension services are generally provided by producer organisations, non-governmental organisations or public entities as a part of social and economic development programmes for particular rural areas. Special development programmes may often focus on certain categories of producers (such as women, indigenous communities, and poor and landless producers). Under certain circumstances, contractors may also provide extension services, especially when they are committed to fair trade standards.

2. Other interested third parties

57. Other parties may hold interests that could affect the parties' ability to perform under an agricultural production contract. The producer's tenure rights and its entitlement to use the land may be uncertain or precarious. If those rights are challenged, the producer may not be able to perform under the contract. Similarly, when the producer leases the land, the landowner will generally need to be informed of certain elements, or may have to authorise them (such as the particular crop grown on the land and cultivation practices, or facilities built to carry out the production). Under particular circumstances based on the contract or applicable law, the landowner may have a claim on the crop itself (such as a lien for unpaid rent). Agricultural production contracts often include a clause concerning the producer's title to the land, and sometimes the landowner may sign the contract. Other creditors, typically banking institutions, may claim rights over the land when the producer has granted a pledge over it for financing and has not complied with its repayment obligations.

58. Also, the rights of the contractor's creditors may affect the producer's rights deriving from an agricultural production contract. This may occur, for example, in the case of a contractor's insolvency, when the producer's rights to payment for the production rank second to the third-party creditor's right over the proceeds of the produce sale. Certain domestic laws, however, would provide special protection to the producer by affording it a priority right.

59. The parties to the agricultural production contract usually cannot modify, dispose of or otherwise affect the third parties' rights. However, it is in the interest of both producer and contractor to ensure clarity in their respective rights and, when appropriate, settle the priority issues that may arise. Special clauses may be included in the agricultural production contract or under separate agreements providing a waiver of rights over the crop or a transfer of the right to payment. It must be noted that terms in the contract involving designated third parties would not affect rights that may possibly be claimed by other third parties.

II. Contract formation

60. A contract consists of the parties' legal obligations resulting from their agreement. The concepts of offer and acceptance have traditionally been used to determine whether and when the parties have reached an

agreement, a contract being concluded when an offer is accepted. Alternatively, in some cases, the parties' conduct can be sufficient to demonstrate the conclusion of the contract.¹ The process of contract formation is very important to building the contractual relationship because it shapes the obligations that will bind the parties over the duration of the agreement. The parties' characteristics and their respective economic position and bargaining power play a major role in the contract's balance (see above, Sections A and B).

61. Contract formation consists of a series of stages and aspects, including negotiations and preliminary exchange of information, delivery of an offer and acceptance of it, and the contract's preparation. As a common best practice, the whole contract formation process should be carried out in a fair and transparent manner and in good faith.² Good faith, while not universally accepted as a principle of contract formation, may involve applying (or refraining from adopting) certain conduct, and may also have implications for the level of information that should be communicated during the negotiation phase. To achieve transparency in the contractual relationship, some form of pre-contractual document might be useful (such as a list of producers involved in the same production, a list of former producers, information about the contractor, rights and obligations of the producer and contractor, investments for production, costs of production, revenue expected, the mode of inspection and monitoring, environmental liability and so forth).

A. Offer and acceptance

62. In the context of an agricultural production contract, the offer containing the agreement's prospective terms typically comes from the contractor. With a view to leaving the opportunity to the producer to appraise fully the future agreement's content, it is a recommended practice in many contexts that an offer be presented in writing with sufficient time before signing, so that the producer may review the proposed conditions thoroughly and, as the case may be, consult with informed persons or entities. A written offer may even be required under certain legislation and, in such cases, to ensure validity the offer's content should reflect the final agreement's content.

¹ For international commercial contracts, a similar rule is stated in Art. 2.1.1, UPICC.

² For international commercial contracts, a similar rule can be inferred from Art. 2.1.15, UPICC.

63. Because mere acceptance is sufficient to form the contract, the offer must be sufficiently descriptive and definite to encompass the agreement's terms.³ Courts will not enforce contracts in which the parties' intentions are not expressed and are incapable of being determined through offer and acceptance. Vagueness, indefiniteness and uncertainty with respect to any of the agreement's essential terms may render the contract unenforceable. As a general rule, the material terms of subject matter, price, payment terms, quantity, quality, and duration must be sufficiently definite so that the respective promises and performance of each party is reasonably certain. In jurisdictions with special rules on agricultural production contracts, these descriptive terms must often be fully included in the written document given to the producer for signature.

64. All agreements, however, will have some degree of vagueness and indefiniteness due to uncertainties in language and communication, especially in international transactions involving multiple languages. Although not in accordance with the good agricultural production contract practices discussed above, seemingly essential terms (such as the precise description of the goods, price,⁴ and time⁵ or place of performance⁶) may, in some circumstances, be omitted from the offer without rendering it insufficiently definite. A court may enforce the agreement as long as the parties intended to be bound by it and the missing terms are determinable through interpretation of other contract language, reference to the parties' established practices,⁷ or application of the principles of good faith, fair dealing and reasonableness.⁸

65. In certain legal systems, open-quantity contracts present particular difficulties. For example, contracts defining the quantity of goods to be delivered by reference to a contractor's requirements or a producer's production ("output or requirement contract") may be subject to specific

³ For international commercial contracts, see the example stated in Art. 2.1.2, comment 1, UPICC.

⁴ For international commercial contracts, a similar rule is stated in Art. 5.1.7, UPICC.

⁵ For international commercial contracts, a similar rule can be inferred from Art. 6.1.1, UPICC.

⁶ For international commercial contracts, a similar rule can be inferred from Art. 6.1.6, UPICC.

⁷ For international sales contracts, a similar rule is stated in Art. 9, CISG.

⁸ For international commercial contracts, a similar rule is stated in Art. 2.1.2, UPICC; but, for international sales contracts, see Art. 14(1), CISG.

rules. In particular, exclusivity may be considered a prerequisite for the enforcement of such agreements. However, where the quantity term is merely imprecise, as opposed to wholly absent, courts may rely on evidence beyond the agreement to supply the required precision. Therefore, care should be taken to specify the quantity and potential exclusivity.

66. Preliminary negotiations refer to the bargaining communications and other events involving the parties prior to acceptance of an offer. Accordingly, every offer is part of the preliminary negotiations until one is accepted. In the event of a dispute relating to protracted negotiations, courts will examine every offer, counteroffer and action of the parties to determine if they have reached an agreement on complete and definite terms capable of being understood by the court.

67. Whether a preliminary communication is an effective offer capable of acceptance or merely a step in preliminary negotiations is an issue to be carefully considered in the agricultural production context, especially in situations of disparate bargaining power. Mere statements of intentions, estimates, advertisements or circular letters, price quotations and preliminary agreements (such as “agreements to agree” or “agreements to negotiate”) may appear to the layperson as definitive offers or binding contracts. Domestic law will refer to various factors in order to establish the legal effect of these communications (including the ordinary meaning of the language used; the parties’ history of dealing;⁹ the degree of targeting of the communication;¹⁰ local and trade usages; the parties’ social relationship; the objective completeness of the bargain’s terms; the agreement’s subject matter; and the foreseeability that the recipient of the information will act in reliance on the communication).

68. Agreements to agree imply an obligation that binds two parties to negotiate and enter into a contract. While certain legal systems are familiar with such agreements where they are recognised to have legal effects, they may be unenforceable in others on account of their indefiniteness with respect to the finality of terms and the intention of the parties to be legally bound. In some circumstances, the parties may have finalised the terms, but lack the intent to be bound until a final writing is

⁹ For international sales contracts, a similar rule is stated in Art. 9(1), CISG.

¹⁰ For international sales contracts, a similar rule is stated in Art. 14(1), CISG.

drafted and signed at some later date. In other scenarios, the parties will conclude separate agreements on a series of terms over the course of negotiations, but no contract will be formed as long as an essential term is still subject to negotiation. Preliminary agreements may then rather be considered as part of the negotiations leading to what may or may not be a final offer. On the other hand, commercial practice has developed different types of pre-contractual obligations (such as letters of intent, memoranda of agreement, etc.), some of which may have a binding character of their own.

69. Negotiations may take place in an informal context that incorporates non-verbal communication, a history of dealings, cultural differences, custom and other circumstances. The parties may leave some terms for future discussions, not viewing them as essential to the bargain. Accordingly, if it is clear that the parties intended to be bound, most legal systems will deem the parties to have concluded a binding agreement. Partial performance by one or both parties may be strong evidence of such an intent, among other factors.

70. Additional negotiations may also occur after the formation of an initial contract. On a related aspect, it may be noted that parties sometimes insert "entire agreement clauses," according to which the single contract document reflects the parties' entire agreement to the exclusion of any separate document or agreement. This kind of clause aims at enhancing the parties' certainty regarding their rights and obligations.

71. Under general contract law, mere acceptance of an offer by the offeree is sufficient to form the contract. A statement – or, under certain legal systems, particular conduct – by the offeree indicating agreement to an offer constitutes its acceptance.¹¹ In circumstances where the start of performance would be a reasonable mode of acceptance, the offeree should provide actual notice of acceptance to the offeror within a reasonable time thereafter. In general, the offer can be revoked if the revocation reaches the offeree before it has dispatched an acceptance, even if different solutions exist in various legal systems. For international contracts to which the CISG applies, the solution is that an offer cannot be revoked if the offer itself implicitly or explicitly states that it is irrevocable or if it was reasonable for the offeree to rely on the offer as

¹¹ For international sales contracts, a similar rule is stated in Art. 18(1), CISG.

being irrevocable and the offeree has also acted in reliance of the offer, even before its acceptance.¹²

72. The applicable law may impose additional requirements that must be complied with in order for a contract to be perfected. This is typically the case when the contract is subject to approval by a Government authority. In certain contexts, third parties' consent may be required, for example, from the owner of the land where the production is to take place. Also, spousal consent may be needed. Furthermore, customary law may impose specific formalities for the contract to be valid. For example, the consent of the community's representative may be required for acts of disposition.

73. Replies to offers that contain additions, limitations or other modifications are generally viewed as rejections of the initial offer and constitute a counter-offer.¹³ Considerable debate exists regarding the effect of a reply accepting the offer while proposing conditions that do not materially¹⁴ alter its terms. Under some systems, unless the offeror objects to the discrepancy without undue delay, a contract is concluded, including the modifications contained in the acceptance.¹⁵ However, if the offeror objects to the modifications, and the parties still proceed with performance, it is unclear which terms apply (*i.e.* those included in the initial offer or those of the purported acceptance or counteroffer).

B. Capacity and consent

74. For an agricultural production contract to be valid and enforceable, the parties, whether natural persons or legal entities, must have legal capacity when entering into it. Domestic law provisions governing legal capacity are usually mandatory.

75. As an additional validity requirement, parties must have given valid consent at the time of contract formation. Consent defects and relative remedies are also governed by mandatory provisions of domestic law.

¹² See Art. 16, CISG. For international commercial contracts, a similar rule is stated in Art. 2.1.4, UPICC.

¹³ For international sales contracts, a similar rule is stated in Art. 19(1), CISG.

¹⁴ For international sales contracts, a similar rule is stated in Art. 19(3), CISG.

¹⁵ For international sales contracts, a similar rule is stated in Art. 19(2), CISG.

76. One potentially sensitive issue in the context of agricultural production contracts is whether the producer had a sufficient understanding of the contract's terms and its implications when entering into the agreement. Lack of informed consent may amount to a defect in consent (for example it may be interpreted as a mistake, either of fact or of law, or fraud making the contract avoidable, or allowing for other remedies). The circumstances of the parties' dealings and the producer's individual situation will play a determining role in assessing whether, in the particular case, the producer's informed consent was indeed absent, what particular ground can be invoked under the applicable law, and the consequences regarding the contract and the available remedies.

77. One particularly relevant aspect in this context is, for the producer, the capacity to understand the contract's terms based on literacy or language. In fact, illiteracy and language barriers are common obstacles to informed consent by producers. In practice, it has been observed that third-party facilitators may play an important role in the negotiation process to ensure that contractual terms are explained and drafted in a language accessible to producers (see below at para. 86). The parties should be aware that the contract might be voidable if one of the parties did not understand the contract's terms.

78. From this perspective, a contract should not impose upon the producer a general prohibition on disclosing the terms and conditions agreed in the contract, thereby preventing the producer from consulting third parties who could advise on the contract's fairness and the material and legal risks it involves. Consequently, certain legal systems have expressly outlawed general confidentiality clauses. When they are not expressly outlawed, they may be declared unfair based on general contract law.

79. Other relevant aspects concern the producer's effective access to informational elements surrounding the contract, and the producer's ability to assess their implications for its particular position under the contract. Whether and to what extent the contractor has an obligation to provide such information may vary. In certain legal systems, based on the general principle of good faith,¹⁶ the contractor would indeed be under a duty to provide certain elements of information before formalising the

¹⁶ For international commercial contracts, a similar rule can be inferred from Art. 1.7 UPICC.

agreement. This objective can also be required by sector-specific legislation that sets out mandatory form and content requirements. The information that a party should disclose will also be commensurate to its relative importance for the other party, of which the first party was or ought to have been aware. This consideration is of particular relevance for contractors dealing with smallholders who may be inexperienced and unsophisticated in negotiating contracts and not have easy access to the relevant information surrounding the contract.

80. For the producer, the risks involved may vary from direct effects to complex consequences. There, the producer's individual capacity and experience will be essential as various issues may be involved (for instance agronomical, financial and legal issues). In this context, facilitators may play a very important role in strengthening the producers' capacities. Again, in certain countries, legislation requires the contract to disclose the risks for the producer deriving from the contract. Whether a lack of awareness, misunderstanding or mistake regarding particular implications or risks (in particular regarding profitability) in fact amounts to a lack of informed consent would therefore be assessed on a case-by-case basis, based on the applicable law and factual circumstances.

81. It may be noted that certain regulations provide for specific mechanisms aimed at affording an enhanced protection to producers in the contract formation process. For example, certain regulations afford producers the right to cancel the contract within a given period (under certain legal systems three days, but it may be a longer period, for example, of one to two weeks) after conclusion of the contract. The producer may exercise this right after having fully considered the contract's implications, and possibly after being advised by a third party. The regulations require for the contract to disclose the producer's right to cancel, the method a producer must follow to cancel, and the deadline for cancelling the contract.

82. With a view to building successful long-term relationships, good practices would recommend that the contractor act in a transparent manner and provide to the producer prior to the conclusion of the contract any information which is relevant not only regarding the contract's performance but also the essential implications and potential risks for the producer. Contracts induced by fraud, mistake or threat may also be voidable by the aggrieved party. With respect to mistake, the erroneous belief must relate to the facts or the law existing at the time of contract formation, not to a party's prediction or judgment about the

future.¹⁷ Thus, an incorrect judgment regarding future crop prices, production yields or weather conditions does not give rise to a mistake rendering the agricultural production contract voidable. Moreover, the mistake must be of such seriousness that enforcement of the contract as it is would not be acceptable or the other party does not deserve protection because of its involvement in the mistake.¹⁸ Similarly, a representation by one party may rise to the level of fraud if it is intended to lead the other party into error and thereby to gain an advantage to the detriment of the other party.¹⁹

83. Improper pressure during the bargaining process in the form of duress or undue influence may make the contract voidable. A threat that presents to the aggrieved party no reasonable alternative but to manifest assent to the bargain could emanate from the other party or from an entity external to the negotiations. In some instances, economic duress or business compulsion may qualify as an improper threat. However, if the other contracting party is unaware of the improper pressure and has acted in material reliance upon the contract, avoidance by the victim is precluded. Undue influence may arise in situations where one party is under the domination of another or, by virtue of the relationship, it may be reasonably assumed that the aggrieved party had engaged in negotiations inconsistent with its own welfare. In the agricultural context, changing market conditions could, in certain circumstances, lead to claims of economic duress (for example in cases of threat to put the supplier out of business). The party claiming duress must generally demonstrate that its acceptance of contract terms was involuntary, and that the circumstances provided no alternative and were the result of the other party's wrongful acts. Wrongful acts may include threats to put one out of business or deprive one of a livelihood, or threats to institute criminal or regulatory actions, in order to secure a private benefit.

C. Role of those who intervene or assist in contract negotiation

84. As seen above (see paras. 43-59), different entities may take part in the contract, have an interest in the contract farming operation, and be

¹⁷ For international commercial contracts, a similar rule is stated in Art. 3.2.1, UPICC.

¹⁸ For international commercial contracts, a similar rule can be inferred from Art. 3.2.2, UPICC and comments.

¹⁹ For international commercial contracts, a similar rule can be inferred from Art. 3.2.5, UPICC.

otherwise involved. When entities other than the contractor and the producer are part of the agreement (such as a public entity or a finance provider), the contract's terms are generally dependent upon the conditions imposed by this entity or submitted for its approval.

1. *Producer organisations*

85. In many contract farming schemes, contractors deal with individual producers. Most transactions are based on predetermined terms and conditions that are set by the contractor in contracts of adhesion, *i.e.* standard form contracts, and leave little or no opportunity for negotiation by the producers. On the contrary, a producer organisation negotiating a contract for delivery of large volumes of produce are likely to have higher bargaining power. Moreover, producer associations or unions, when sufficiently representative, may have an important advocacy role and strengthen the position of members in dealing with contractors. In certain contexts, contractual terms are agreed at the inter-professional level between producer organisations and buyers on a commodity basis and for a specific area and duration that would form a model or standard agreement with which individual contracts may or should comply.

2. *Facilitators*

86. Depending on the particular environment, different entities may act as a facilitator (such as Government entities, producer associations and non-governmental organisations, or development agencies and individuals). Facilitators may have an especially important role in assisting the parties in setting mutually-advantageous conditions, in particular by providing support and advice to producers before and at the time the contract is concluded and by building trust between contractors and producers so that they fully understand the agreement's terms. Facilitators should not make decisions for the parties but may have a mandate to represent either the contractor or the producer in negotiating with the other party and signing the contract. They may act as witnesses when informal agreements are concluded.

3. *Public authorities*

87. Where sector-specific legislation is in place, a public entity may have authority to bring the parties to the production contract together and oversee the contract's conclusion, and review its compliance with

specific form and content requirements. Certain systems provide for a formal approval or registration of contracts (with the payment of related fees), for different public policy purposes. One possible application is publicity towards potential third-party buyers that a particular producer is under an exclusivity contract with another contractor. Depending on the legal system, the submission for public review may be voluntary with a view to providing certainty regarding the contract's conformity with form requirements. Public authorities also have a wider enabling role, as noted elsewhere in the Guide (see above at paras. 39-42).

4. Intermediaries

88. Most contract farming arrangements are negotiated or concluded by a person who represents and acts on behalf of either the producer or the contractor. A contract concluded by a representative or an agent is binding upon the party represented. Matters regarding the form of the authority, and the consequences of an intermediary acting beyond the scope of its authority are addressed by representation and agency rules under domestic law. Such rules differ greatly among legal systems and may even vary within each legal system.

89. For a producer, in certain circumstances, distinguishing between a company's representative (*i.e.* employee or agent) and an autonomous entrepreneur acting as a subcontractor for a company may not be easy. However, this has important legal consequences as it implies different liabilities and remedies. When an entrepreneur is autonomously engaged as a main party to the contract farming arrangement, it would take over the risks deriving from the producer's or its own failure and would be linked under a separate supply contract to the company. On the contrary, a mere intermediary would undertake no personal responsibility for the obligations under the agricultural production contract. This emphasises the importance of ascertaining the status of the person negotiating and concluding the contract. Unless it can be clearly inferred from the circumstances, including the particular relationship's context and history, it is recommended to obtain formal documentation regarding the person's identity and actual authority to represent the other party.

90. As seen above (see paras. 86-90), producers may in some cases also be represented (for example by a producer organisation or a facilitator who acts on its behalf). Again, the authority to this effect should be clearly established. From this perspective, it would be advisable that, when signing an agricultural production contract, the

employee or agent specifies its status and not only signs in its own name but adds language such as “for and on behalf of,” followed by the principal’s name, thereby avoiding any risk of being held personally liable under the contract. Some more detailed wording may be inserted in the agricultural production contract itself.

III. Contract form and content

91. As a starting principle, contracts are generally not subject to any requirement regarding form or content.²⁰ However, mandatory requirements may be applicable in certain legal systems in this regard. Also, it should be kept in mind that form and content of contracts can be very diverse depending on multiple factors, such as the parties involved, the particular commodity, applicable usages, etc. This section explores a range of common practices and rules with respect to the form and content of agricultural production contracts.

A. Contract form

92. In most cases, the contract will take the form of a written agreement – either a single, comprehensive document or a series of emails, invoices and other correspondence. When one party has limited literacy, an oral explanation may accompany such an agreement.²¹ On occasion, due to industry usages, local practices, the parties’ desires or other circumstances, the production contract will be an oral or “handshake” agreement, concluded without any documentation.²²

93. As a matter of good contracting practice, written, straightforward and simple contracts are encouraged as a means to improve the clarity, completeness, enforceability and effectiveness of the parties’ agreement. Care should be taken to try to reduce complexity where possible and to ensure that contracting parties with limited literacy skills fully understand the terms (for example by having a neutral third party read the written contract aloud before its signature).²³ The promotion of transparency,

20 For international commercial contracts, a similar rule is stated in Art. 1.2, UPICC.

21 For international commercial contracts, a similar rule can be inferred from Art. 1.2, UPICC.

22 For international sales contracts, a similar rule can be inferred from Art. 11, CISG.

23 For international commercial contracts, a similar rule can be inferred from Art. 3.2.7(1)(a), UPICC.

open communication and close collaboration between the contractor and the producer are key tenets not only at the contract formation stage, but also throughout the contractual relationship. Similarly, in some regions, it may be uncommon to have comprehensive written contracts, so it is important to cater also to oral agreements through trust. For example, when the parties conclude an oral agreement, they should do so in the presence of a third party having no economic interest in their relationship. This may help overcome the difficulties in enforcing oral contracts by making it easier to prove the terms to which the parties agreed.

94. The fundamental principle of freedom of contract provides that parties are free to enter into a contract and to determine its specific content.²⁴ In an effort to reduce transaction costs, contractors very often make an offer to enter into an agricultural production contract to multiple producers on standard forms, using standard terms, and incorporating by reference standards contained in other documents. Producers may also appreciate standardised contracts, especially if they know that their peers have entered into the same arrangement, thereby fitting within a cultural pattern.

95. However, the legal freedom to enter into any contract may be overshadowed by the lack of economic freedom to negotiate specific terms or reject a lawful, yet economically unbalanced contract. There is a concern that non-negotiable contracts of adhesion are often drafted the stronger party's favour. Accordingly, domestic rules on contract interpretation may entail that any ambiguity will be construed against the contract drafter. Conversely, where a literal-minded reading of a contractual term would give a party more than is reasonable with respect to the contract as a whole, the applicable law may permit a more liberal interpretation. In instances of gross disparity, when accepted by the applicable law, the affected party may avoid the contract or ask a court to modify it in accordance with reasonable commercial standards of fair dealing.²⁵ Of course, the economic efficiency and the practical meaningfulness of *ex post facto* (i.e. after the fact has occurred) protection of the producer through litigation is highly questionable in view of limited practical accessibility to the courts and, especially for smallholders, the discounted value of relief available. It should be noted

24 For international commercial contracts, a similar rule is stated in Art. 1.1, UPICC.

25 For international commercial contracts, a similar rule is stated in Art. 3.2.7, UPICC.

that avoidance or adaptation for “gross disparity” is not accepted everywhere.

96. In light of the potential disparity in economic power between the parties, unequal information and anti-competitive practices, some jurisdictions have enacted specific regulations regarding the required form of agricultural production contracts in an effort to improve the functioning of agricultural supply chains. Due to various domestic legal traditions, legal rules and norms governing agricultural production contracts, jurisdiction-specific rules may be found in civil codes, agrarian codes, general contract legislation, specific agricultural contract legislation, as well as sector or product-specific legislation. The specific requirements thus implemented range from readability standards to the substantive terms of the agreement.

97. To mitigate possible misunderstandings, contracts should be written in a language familiar to both parties and should avoid complex and unclear terms, so that a producer of average education and experience in the given region can understand them. Some jurisdictions specify typeface sizes and require the use of sections, captions and indices to facilitate the understanding of longer documents. The use of technical terms may be outlawed unless they are customarily used by producers in the ordinary course of business.

98. Agricultural production contracts may specify production or handling standards, or include other technical terms. In such situations, some jurisdictions require that the contract provide a full explanation of these special provisions within the written document signed by the parties, and that any documents incorporated by reference be attached to it. Other disclosure requirements may compel the contractor to disclose specifically the material risks to the producer. Again, these obligations regarding contract form go beyond general contract law to minimise misunderstandings and anti-competitive practices arising due to disparity of economic power or unequal information between the parties.

B. Contract content

99. Apart from requiring sufficient identification of the parties and the object of the agreement, general contract law, in most legal systems, does not set detailed content requirements for a contract to be valid. However, some rules specifically applicable to agricultural production contracts generally impose additional content requirements in the interest of transparency and provide information to the parties regarding

several essential aspects. These relate to the content and extent of the parties' core obligations and may cover other aspects that are determinant in the overall balance of benefits and risks deriving from the agreement.

100. Certain regulations go into great detail regarding the matters for the parties to include in the contract. This is the case when model forms of contracts are imposed upon the parties. In such cases, procedural protection (*i.e.* the parties' obligation to include a provision dealing with a certain matter) may be combined with substantive protection (*i.e.* the parties' obligation to include a provision with a certain content). Several systems also require that the parties should specify available mechanisms for dispute resolution, sometimes requiring the parties to have recourse to mediation prior to turning to any binding mechanism.

101. Subject to any applicable legislation, it is in the parties' interest to address the relevant elements of their contractual relationship in a complete and detailed manner. Although agricultural production contracts may take many forms in order to account for the diversity of products, stage of the supply chain, legal systems and social norms, several important components are present in most written arrangements to enhance transparency and convey complete information. In practice, it has been observed that there is a general convergence of clauses and conditions across the spectrum of contract farming and different commodities and countries.

102. *Parties.* Most contracts start with an identification of the parties. In the agricultural context, this usually includes the name and contact information of the producer and contractor. In addition, it may include a description of the land or livestock under production with respect to the particular contract, specifying for example the number of acres, geographic location or specific livestock. For a more thorough discussion of the parties to a production contract, including third parties, producers' associations and Government regulators, see Part I, above.

103. *Purpose.* This clause outlines, often very succinctly, the reason underlying the contract (for example "Agreement to Grow Tomatoes"). It may identify the commodity to be produced by the producer and purchased by the contractor. In legal systems that require "consideration" or "cause" for the validity of contractual obligations, it may be useful to insert a clause within this section of the contract summarising or at least acknowledging the parties' respective obligations. The contract's purpose is also commonly expressed in the initial recitals or a preamble. In some

cases, the preamble will be used in interpreting the contract's content and the parties' intentions.²⁶

104. *Identification of the production site.* Contracts typically identify the production site. Regarding land, the particular size and location of the contracted tract (generally determined based on land registries) may determine the content and scope of the parties' obligations (for example when the delivery and purchase obligations refer to the whole production from the designated plot).

105. *Obligations of the parties.* The agreement should specify the obligations of both the producer and contractor, and in fact, most of the content of an agricultural production contract typically consists of recitals of the parties' obligations. In a written document, these may be in separate sections. Common producer obligations may include production and handling requirements, use and payment of specific inputs to meet market requirements, location and timing of delivery, quality standards, and whether it is a volume (*i.e.* quantity) or acre contract. Production obligations may also include compliance with the contractor's intellectual property rights (such as trade secrets and patented or protected seeds). Contractor obligations often include specifications or provision of production inputs (such as seeds, chemicals and land, technical assistance services, production oversight, communication of product quality testing standards, and delivery acceptance, for a complete discussion of the parties' obligations, see Chapter 3).

106. The price and payment terms go to the heart of the parties' bargain and are an important part of the parties' obligations and merit separate mention here. Accordingly, a contract will usually stipulate the price to be paid or contain a provision for its subsequent determination. As a matter of good practice, the contract should have a clear and transparent method for determining the price. In the absence of a specific agreement by the parties, applicable law may empower an adjudicator (a court or arbitrator) to infer a reasonable price in accordance with default criteria provided by the law.²⁷ Other provisions include specifications on when

²⁶ For international commercial contracts, a similar rule can be inferred from Art. 4.4, UPICC.

²⁷ For international commercial contracts, a similar rule is stated in Art. 5.1.7, UPICC.

and in what form the contractor will transfer payment to the producer (for further discussion of price and payment terms, see Chapter 3 at 145-163).

107. Similarly, the provision of inputs is an aspect of obligations that is also worth a separate mention. The agreement should reasonably identify the physical inputs. There is no set rule on how this is done, but it is common to refer to the inputs by technical specifications or commercial brands. Regardless of how the inputs are described in the agreement, as with all terms of the agreement, they must be described with enough specificity to allow enforceability. Inputs are an essential term of the agreement if the inputs are to be provided by the contractor. Unless the inputs' prices are set or regulated (for example, to prevent excessive prices) by Government regulation, this is a term to be agreed upon by the parties. As an essential term to the agreement, the failure to set or have a basis to determine the price of the inputs could result in a failure of assent (see Chapter 3, para. 68-69).

108. Determination of the price of the contractor's inputs is an important matter, which should be clearly explained in the contract. It should be done with due consideration to the corresponding market prices, as well as to the pricing mechanism which will govern payments to be owed by the contractor to the producer. Because the cost of inputs is often related to the payment to the producer for produce, a well-drafted agreement will logically connect the description and pricing of the inputs with the overall payment terms of the agreement so that all aspects of costs and payments can be compared easily. Failure to do so may subject the contractor to a different payment scheme based on default terms that were not contemplated by the parties.

109. *Excuses.* Agricultural production contracts are particularly vulnerable to occurrences that make performance impossible or significantly more challenging than what was envisaged at the time of entering into the contract. The contract may specify the risk of loss for *force majeure* events or change of circumstances and, if available, insurance obligations (for further discussion of excuses for non-performance, see Chapter 4).

110. *Remedies.* The contract may include designated remedies in the event that one party fails to meet its obligations under the contract. Parties may design different remedies depending on the nature of the breach, but they should be aware that the applicable law may provide

specific limitations restricting the use of contractual remedies (see Chapter 5 on Remedies for further discussion).²⁸

111. Other related elements found in agricultural production contracts include: clauses limiting or excluding liability for non-conformity often accompanying the supply of inputs by the contractor, as well as limitations on damages and liability between parties arising from the contract; allocation of responsibility for waste disposal; potential environmental liabilities; responsibility for obtaining and complying with public permits; provisions for successors and the assignment of rights; contract renewal provisions; and entirety clauses prohibiting oral modifications of the underlying agreement.²⁹

112. *Duration.* The duration of the contract may vary depending on the production cycle and the applicable law. For contracts stating no specific duration, the contract term may be implied based on the crop type. For example, a contract to grow maize – an annual crop – is implicitly limited to a single year. On the other hand, contracts imposing a substantial financial obligation on one party (generally the producer) may imply a more durable relationship and an expectation of renewal and continued purchasing by the contractor (see Chapter 6, para. 4).

113. *Renewal.* Renewal may result from a separate express agreement to extend the duration of the existing contract, from an automatic provision incorporated in the initial contract, or tacitly from the continued behaviour of the parties after the expiration of the fixed term. Oral contracts extending beyond one year may, in some jurisdictions, trigger a requirement that contracts performed over more than one year be in writing (see Chapter 6, Part II, Renewal of contracts).

114. *Termination.* Contract termination discharges the parties from their respective obligations flowing from the agreement. It may happen automatically, by agreement of the parties, or under a right arising from the other party's non-performance. To increase clarity and certainty, production contracts should specify the situations and procedural requirements for contract termination (such as a notice period)³⁰ (see Chapter 6, Part III, Termination of contracts). They can also provide for

28 For international commercial contracts, a similar rule is stated in Art. 3.2.7, UPICC.

29 For international sales contracts, a similar rule is stated in Art. 29, CISG.

30 For international commercial contracts, similar rules are stated in arts. 5.1.8 & 7.3.2, UPICC.

different remedies in case one party breaches its contractual obligations (see Chapter 5, paras. 23-27, 85-89, 127-148).

115. *Dispute Resolution.* Any contractual relationship may give rise to disputes arising from non-performance events deriving from parties' breaches of obligations, or even from external factors not depending upon the parties' behaviour. Accordingly, production contracts should incorporate at the outset methods for dispute resolution. Common forms include judicial proceedings, arbitration and amicable procedures such as mediation or conciliation. These provisions add important procedural certainty to contract interpretation, execution and termination (for further discussion on dispute resolution mechanisms, see Chapter 7).

116. *Signature.* In written contracts, there should be a distinct section that, in addition to the parties' signature, includes the date and place of contract formation. As a good practice, the parties should sign in the presence of a witness and include its signature on the document.

C. Consequences of breach of required form or content

117. Whenever the applicable law requires an agricultural production contract to be made in writing or imposes other requirements on form (*e.g.* sufficient readability) or substantive content (such as the inclusion of clauses addressing specific obligations of the parties), it would generally also specify the consequences of noncompliance with such requirements.

118. There are legal systems where the written form is required. It may be set as a condition for the contract to be valid, in which case the contract will be declared void if the requirement is breached. Alternatively, when the writing requirement serves evidentiary purposes only, oral contracts are generally valid. If the existence and contents are challenged, however, they will generally have to be proved in writing (subject to possible exceptions) and the failure to do so may render the contract unenforceable.

119. If the applicable law is silent regarding the consequences of breach of a form requirement, depending on the legal system, methods of interpretation differ. One widespread trend is to consider the freedom of contract an overarching principle and to interpret strictly any exception to the principle (such as formal requirements), with the consequence that the written form may be considered as serving purposes of evidence or publicity only.

120. Breach of other formal requirements may result in various sanctions depending on the applicable law: from avoidance of the contract as a whole, to civil and administrative penalties (fines or cancellation of the contractor's license or the contractor's entitlement to benefits under the publicly supported contract farming scheme). Certain systems would allow revision of the contract by the court.

CHAPTER 3 – OBLIGATIONS OF THE PARTIES

1. This Chapter examines the obligations on parties that derive from an agricultural production contract. The producer's main obligation is to produce and deliver the goods to the contractor in accordance with the contract's specifications and requirements, often using inputs and financing received from the contractor. The contractor, in turn, undertakes to purchase the product or, depending on the arrangement, to remunerate the producer for the services rendered in the commodity's production. Agricultural production contracts often give the contractor the right to exercise oversight of the production process, which may include provision of inputs, instructions and technical guidance.

2. The obligations typically assumed by the parties under an agricultural production contract can be broadly grouped in two categories. Several obligations are directly concerned with the physical characteristics of the goods to be produced (quality, quantity, delivery time) or the corresponding remuneration (price, time of payment). These obligations can be described as "product-related" obligations. Other obligations are immediately concerned with the process through which the goods are produced (method of production, technology used, working conditions) and may include detailed management measures. Some of them may be more directly aimed at achieving the desired physical characteristics of the goods (time and method for seeding, quantity and manner of using fertilisers) or meeting safety standards (use of pesticides, hygienic conditions), whereas others may only remotely relate to product quality in a physical sense and be more closely associated with intangible attributes sought for the product or the process (compliance with environmental and sustainability standards, community benefits, gender and indigenous populations concerns). These obligations can be described as "process-related" obligations.

3. It is important to understand that the obligations of producers and contractors are typically interlinked, with the result that one party's performance will often depend on the other party's compliance. Indeed, each of the parties' obligations may have a corresponding or related obligation on the other party. For example, the contractor's obligation

to supply technical instructions may be interlinked with the producer's obligation to follow those instructions. Therefore, this Chapter examines together the obligations of both the producer and the contractor in respect of each of the contractual objectives and stages of performance. It first introduces key aspects of risk allocation between the parties. Next, the core obligations of the parties to an agricultural production contract are explored. Many obligations may occur over a period of time, or at various points during an agricultural production contract's life, and special care is taken to highlight this possibility, where relevant, when each obligation is discussed.

4. This Chapter's final section analyses several broad obligations and issues that may arise at any stage in an agricultural production contract's performance. It is important that both parties are aware of these obligations during the entire course of their performance. This Chapter, moreover, is tailored to agricultural production contracts concluded between an individual producer and an individual contractor. As discussed in the Chapter on parties to the contract, the contractual arrangements may be more complex than this two-party arrangement.

5. This Chapter's focus is on obligations that flow from the provisions of the contract itself. However, parties should always be mindful of obligations that may derive from other sources (see Chapter 1 on the Legal Framework). For example, when the producer hires employees, the producer is subject to the requirements imposed under applicable labour and social law (such as working hours, social contributions, safety conditions at the work place, and bans on child employment). It is not uncommon that, although such laws are applicable as a matter of public regulation, some agricultural production contracts expressly spell out these obligations as well.

I. Risk allocation

6. The parties' obligations under the contract are intrinsically related to how the parties intend to allocate and compensate for risks. Conceptually, when parties draft a contract and include obligations that bear upon one party or the other, they are also allocating risks that will fall upon one party or the other. The main risks to which the parties are exposed during the contract's life can be divided into two broad categories: (a) "production risk," that is, the risk of loss or shortfall of production by expected or unforeseen events that arise during production; and (b) "commercial risk," that is, the risk that the produce's

actual market value upon delivery or marketing may be lower or higher than the price the parties' anticipated when they set the price or the formula for its calculation.

A. *Production risk allocation*

7. Events that happen during the production phase (such as inclement weather) may cause a shortfall or even the entire loss of the produce (see also the discussion of supervening events on Chapter 4 at paras. 2-4). These events are collectively referred to as production risks. Typically, the contract will contain provisions specifying which of the parties bears the risk of loss and which party is responsible for securing the quantities needed to meet contractual requirements. These provisions, and the resulting obligations, must be understood in light of the default risk allocation that may be provided by applicable law.

8. To fully understand the options for production risk allocation under in an agricultural production contract, it is important to appreciate legal implications of holding and transferring title to the goods. Title to goods may generally be thought of as ownership of the goods, so that transferring title means transferring ownership. One implication of a party's right to the goods is the right of the owner to dispose of them by sale or other disposition. Another important consequence of ownership is the owner's potential bearing of risks of deterioration, loss or damage to the goods. Whether a party holding title bears production risks depends on the contractual provisions and applicable law, but under the default rule applied in some systems, these risks are placed on the party that holds title to the goods.

9. Seen from this perspective, title in agricultural production contracts can follow two broad patterns. In the first pattern, similar to an ordinary sales transaction, the producer owns the particular goods and will deliver them to the contractor. In the second pattern, the contractor is the owner of the raw material and the transformed product during the whole production process. In this latter case, the producer's status is similar to that of a services provider. For both patterns, both parties' obligations will depend on which party has title to the goods and the inputs at the relevant time.

10. In some legal systems, transfer of title occurs when the buyer takes possession or delivery of the goods. In these legal systems, transfer of risk of loss would normally occur at the time of taking possession or delivery. Under certain other legal regimes, the default rule is that risk of loss

follows physical control over the goods. This is justified by the fact that the person in possession is usually in the best position to care for the goods. This is common in contracts such as a lease, loan, bailment or deposit, where the person having the use or custody of the goods bears the risks, and not the owner of the goods. Subject to the obligation of good faith, the default rules that govern risk of loss can usually be changed by a provision in the contract.

11. Two additional issues are of particular concern for the contractor. First, it is important for the contractor that the producer has valid and sufficient rights over the land and produce. Second, the contractor must know when title passes. This question of title may be factually complex because of the fungible nature of goods (*i.e.* able to be directly substituted) that are to come into existence in the future. As for the producer's rights in the land and the goods, mandatory provisions generally apply to protect the rights of third parties. However, as between the parties, it is not uncommon for the contractor to require assurances from the producer that the producer is a legitimate holder of the land, has full title over the produce, and that no other party can assert rights over the production, land tenure rights, security rights or other claims.

12. One issue that is of particular concern to producers is that some contracts attempt to establish the contractor's title to the crop while also placing all the risk of loss on the producer until the crop is delivered. Thus, in many agricultural production contracts, the producer does not have any legal right or title to the crop while it is being raised. This is designed to protect the contractor's financial interest in the crop from claims by the producer's obligees, and to protect any intellectual property rights in the genetic material (see below at paras. 95-104 for further discussion of intellectual property rights). However, many contracts also provide that the risk of crop loss (such as by weather or disease), rests with the producer. In other words, if the crop is successful, the contractor owns it; if the crop is lost, the producer is responsible and earns no compensation. This form of agreement is a classic example of risk shifting, because it guarantees the contractor's right to the crop without exposing the contractor to the risks of production. Another concern for the producer arises in situations where the risk shift might not take place even after the contractor has taken possession and ownership of the produce. In such cases, if a later rejection by other parties down the supply chain occurs, the burden will still be on the producer.

B. Commercial risk allocation

13. “Commercial risk” in an agricultural production contract means the risk that the production cannot generate the expected revenue because of changes in market prices or commodity demand. Both of these risks may impair the parties’ ability to recoup their investment and may compromise the project’s financial viability.

14. The basic motivation of contract farming is for the contractor to control commercial risks by, on the one hand, agreeing on a fixed price or at least a pre-established price calculation formula, which protects against unfavourable price fluctuations; and on the other hands, requiring compliance with predetermined volume, quality and production standards, which reduces the risk of rejection of the produce by the intended customers along the value chain. The particular market and commodity and the business structure sought by the contractor will influence the level of integration established by an agricultural production contract. Tightly integrated relationships are common for production destined to be sold in oligopolistic markets (*i.e.* controlled by a small group of firms), or where contractors have developed specialised lines of products requiring specialised raw materials and production methods that confer a specific market identity on the final product. Tightly integrated relationships typically translate into various specific obligations (such as the producer’s obligation to use exclusively the contractor’s inputs and technology, see below at para. 66). To guarantee production that meets the contractor’s precise market requirements, the contract normally requires the producer to acquire specific knowledge for the contracted production and make capital investments in installations and equipment in accordance with the contractor’s specifications (see below at paras. 75-77).

15. The producer is usually subject to close monitoring and oversight during the various processes involved in production. Typically, the contractor secures an exclusive right to acquire the product in addition to possibly having proprietary rights (*e.g.* full ownership, patent or proprietary rights) over the inputs, technology and the product during the entire production process.

16. In addition to providing for the control, mitigation and allocation of commercial risks resulting from marketing failure, the contract typically also takes into account commercial risks that result from price fluctuations. From the contractor’s perspective, the main risk is that the price fixed in the contract, or obtained through application of the

contractual price calculation formula (see below at paras. 149-158) may be higher than the current market price for a commodity of the same quality. If the demand for the final product is elastic, or competition is high, the contractor may not be able to pass price increases to the consumers, and may have a lower profit than originally anticipated. Conversely, from the producer's perspective, a contract price that is lower than the market price or is insufficient to protect the producer's profit against rising costs (*e.g.* wage, power or fuel cost increases) makes the contract unattractive or even disadvantageous. In either case, the parties may have an incentive to breach the contract. The risk of default is greater with simple commodities that can be more easily purchased from substitute sources or sold to competing buyers. The more complex the production, the closer the interdependence between the parties.

17. Commercial risks are largely controlled and mitigated through the price mechanism established in the contract. The more the parties are able to devise a mechanism that preserves the contract's mutual profitability despite price fluctuations, the greater the chance that the parties will be able to establish a sustainable contractual relationship. It is important for the parties to bear in mind that erratic pricing and poor management of risk is often the result of poor market information, which underscores the need for a developed business plan at the time of contract negotiation.

C. Exclusivity

18. To control both production and commercial risks, the parties often reinforce the delivery obligation and the price mechanism by an obligation of exclusivity. Exclusivity in this context means that the producer undertakes to deal only with a particular contractor. Most often, exclusivity requires not only the delivery of the commodity to the contractor, but also the supply of all or most inputs from the contractor. The concept of exclusivity is closely related to the quantity of product to be delivered to the contractor (see the discussion on quantity below at paras. 24-41).

19. Exclusivity obligations are often an obvious consequence of the business model on which the contract is based. For instance, if the contractor has retained title over the goods it naturally follows that the whole production has to be returned to the contractor (subject to possible minor exceptions, *e.g.* allowing the producer to keep small quantities for its personal use). The result is different when the

production legally belongs to the producer. In this situation, however, many agricultural production contracts still oblige the producer to deliver its production exclusively to the contractor. This can be justified by the contractor's provision of substantial inputs to the production process (such as sowing or planting material and technical assistance). This obligation may also arise from the contractor's undertaking to purchase the whole production.

20. The producer, however, must be aware of the risks that may be involved in granting a monopoly over its whole production to a single contract partner. Under an exclusive relationship with a contractor, the producer generally loses much or all of its economic independence, as a result of its reliance on the contractor for access to the market, and on the contractor's conditions for price, inputs and credit. Through this economic dependency, it is likely that the producer, for fear of losing the contract, will have little means to oppose possible abuses or unfair conduct by the contractor. To guard against this, special protective provisions are generally available under domestic law.

21. Exclusivity clauses alone may not be sufficient to ensure contract performance if the price mechanism or method of payment fail to guarantee an adequate profit level or where the incentives for breaching the contract outweigh the costs of liability for breach. A change of market price or the possibility of earlier or immediate payment may encourage an opportunistic producer to breach its obligation to deliver the produce to the contractor and sell the produce to a third party. This practice, known as "side-selling," is more likely to occur when there is an obligation of exclusive delivery, but it could also occur when the contract requires a fixed delivery amount. If the contractor owns the product or if the contract is for the entire production, then side-selling is prohibited. However, it is important to distinguish outright instances of "side-selling" from the case where production is for a set quantity and there is excess production (in which case the excess may be sold to third parties, possibly after right of first refusal by the contractor). In practice, side-selling typically occurs when the producer perceives the benefits of breaching the contract as greater than the loss of that contractual relationship. To avoid side-selling, contractors may provide flexibility in delivery by allowing producers to retain a small quantity for sale outside the contractual relationship. The producer, however, would still be obligated to reimburse for the inputs and services provided by the contractor.

II. Core obligations of the parties

22. In an agricultural production contract, the producer's primary obligation is to produce the goods in accordance with contractual specifications and requirements. This obligation may entail a wide range of underlying sub-obligations and requirements. Concomitant with the producer's obligation is the contractor's obligation to purchase the production, or if the contractor owns the produce, to take delivery of it. Thus, the contractor's primary obligation is to pay the price. During production, the contractor may also have several corresponding obligations (such as the obligation to provide specified inputs and the obligation to oversee production).

A. *The product*

23. The agreed quantity and quality of the products are central to the obligations of production and delivery. The extent of the product-related obligations assumed by the parties can be complex. For example, quantity is not only commensurate to the quantity of inputs provided, but will often depend on their quality. The quantity and quality of production will also depend not only on the standard of care used by the producer, but also on the method and means of production applied, which are often established by the contractor. The extent of each party's obligations for the provision of inputs and the production methods determines the risks that each party assume for loss, shortage or poor quality. This section examines issues that relate to quantity and quality.

1. *Quantity*

24. Often, the contractor agrees to pay for the producer's whole production. Some contracts, however, provide for the purchase of only a portion of the future crop, a specified quantity, a minimum quantity, a quota, or a variable quantity. Some contracts state that the quantity will be determined later on the basis of field tests conducted as the crop grows. Similar arrangements can be found in agricultural production contracts dealing with animal husbandry.

(a) *The whole production is purchased*

25. An agreement for the contractor to acquire the "whole" production may indicate several possible measurements, and its meaning should be clearly specified. If the "whole production" is intended to mean all

output that is produced from a specific plot of land, then the precise location, and possibly also the surface area of the land should be set out in the contract. If the “whole production” is meant as the crop grown from the inputs provided by the contractor (such as seeds or planting material), this needs to be expressly stated in the contract. Similarly, in those animal husbandry contracts that require the contractor to supply the animals, the normal expectation is that the whole production refers to all of the animals. This, of course, should be plainly stated in the contract. The parties might also define the “whole production” merely by reference to everything that the producer produces.

26. The “crop” is usually the crop of an identified season, but it could also be the crop of several seasons or several crops within a single season. The contract should specify what is included in the “crop.” Some contracts that provide for delivery of the whole crop include an estimate of the quantity to be produced. This normally takes into account the uncertainty that may usually affect crop production. Clauses dealing with *force majeure* may provide for an adaptation of the quantities if part of the crop is lost due to weather conditions.

27. The producer’s obligation to deliver the whole crop to the contractor implies that the latter has exclusive rights over the production, which means that sales to third parties are not permitted (see the above discussion on exclusivity at paras. 18-21). The producer’s obligation to deliver the whole production to the contractor requires that the producer deal with the contractor on an exclusive basis for the production. There is no presumption, however, that the contractor will have an exclusive relationship with the producer. Although there is no particular legal impediment preventing both parties from entering into an exclusive relationship, more commonly contractors deal with large numbers of producers, thereby allowing greater overall production as well as lowering the risks of an individual producer’s failure.

28. In exclusive contracts, *i.e.* when the producer has to deliver all of its output or all the output produced from particular land, any type of side-selling amounts to a breach of an obligation (see Chapter 5 at para. 89). Moreover, the producer may be in breach of its obligations if, even without engaging in transactions with third parties, the producer delivers a limited quantity or poor crops due to a lack of effort, whether or not the contract is exclusive.

29. From the contractor’s perspective, the major concern arising out of a producer’s side-selling is the contractor’s inability to obtain

replacement goods complying with contractual specifications from other sources not previously obliged to produce according to the contractor's requirements. Moreover, the goods might also contain inputs from the contractor over which the contractor may want to retain control. The contractor may protect itself from this risk by providing that the produce is only available for alternative sale by the producer when the delivery is refused for lack of conformity. When the produce incorporates inputs in which the contractor holds intellectual property rights, the contract may provide – to prevent side-selling – that the produce is to be destroyed.

30. The prohibition against selling to another party may be explicitly stated in the contract, but the contract may also achieve the same result implicitly by providing a link between the producer's obligation to reserve all its production for the contractor and the contractor's undertaking to buy the whole production. In many contracts providing for delivery of the whole production to the contractor, this is not made explicit, because it may appear to be self-evident. However, the issue of "side-selling" is one of the main points of concern for many contractors, and an express term is certainly advisable.

31. Agricultural production contracts sometimes provide for express exceptions to an otherwise binding exclusivity clause. For example, sales to third parties may be permitted with the contractor's consent. It is also not uncommon for the contract to provide for an exception if the contractor informs the producer of its inability to purchase the contractual quantities. In addition, limited exceptions are sometimes allowed for small quantities that the producer may keep for personal use or sale on the local market.

(b) Only part of the production is purchased

32. To ensure a foreseeable and constant supply for the contractor, the contract often provides for the purchase of a specific quantity, which may only be a portion of the producer's production. This allows both parties to know in advance what quantity is required under the contract, although it places the risk of underproduction on the producer. Depending on the legal system, however, and unless otherwise agreed, the law may impose on the contractor an implied obligation to help ensure that the producer can meet its obligation (for example, by refraining from making demands of the producer that the contractor should reasonably know the producer cannot meet). Quantities produced above the contractual amounts are in principle left to the producer's free disposal.

33. If the producer's obligation does not extend to the whole crop, it normally follows that the producer is free to sell the additional quantities to third parties. Thus, most contracts of this type do not include any restrictions on third-party sales, but there can be exceptions. For example, it can be stipulated that no other agricultural production contract may be entered into with a third party (depending on the contract's terms, with or without the contractor's consent). If the producer has the right to sell the amount over the stipulated quantity – whether agreed as a particular quantity or percentage of the whole production – it is not uncommon for the contractor to have a right of first refusal. In this case, it is advisable to provide how this right may be exercised (time limit, notice, etc.). To avoid crop deterioration, the producer should know quickly whether it is allowed to sell the excess to third parties.

34. Certain contracts provide for the obligation to deliver a certain percentage of the whole production. The percentage is normally high enough to represent a sufficient part of the producer's production and still justify the existence of a detailed contract, with mutual obligations relating to methods of production, quality requirements or various inputs by the contractor.

35. Agricultural production contracts can also provide for the delivery of determined quantities of the goods, with no reference to the whole crop. As in the case above where only a percentage of the crop was purchased by the contractor, the specified quantities are normally large enough to justify the existence of a contract providing for the mutual obligations between parties characteristic of agricultural production contracts.

36. Some contracts provide for the purchase of a minimum quantity of goods. Here, reference may sometimes be made to an "initial minimum" quantity that seems to indicate that the parties contemplate additional deliveries, but the lack of further express legal obligations creates uncertainty that can be avoided by providing guidance in the contract. If the contract obliges the producer to grow a minimum quantity, it should clarify how any excess is to be handled.

37. Agricultural production contracts often provide that the producer should meet a quota, based on an allocation among producers. This allocation is usually provided by the contractor, who will have similar arrangements with several other producers. The quota may also derive from public regulation. Where there is a quota, the contract should be

clear whether the quota sets a minimal requirement, a maximum, or both. The contractor's main concern is usually to avoid insufficient production, but over-production can also be a problem. The producer should know precisely what is required to meet the quota. If the quota is a minimum quantity, the contract should state whether the contractor will purchase any or all of the excess. The contract should also explicitly state whether the producer can freely dispose of the production once the quota has been reached. For the producer, taking advantage of this provision presumes that there is an alternative market, which is not necessarily the case. The quota may work as a maximum not to be exceeded. This can be the case when an applicable regulation stipulates production limits. The quota may also be both a minimum and a maximum requirement. In this case, the contract may provide that if the minimum is not met, the producer will pay a penalty; if the quota is exceeded, the price will be reduced. An explicit choice should be made among these different quota systems to avoid any misunderstanding that may arise from a simple reference to the term "quota."

38. It may be advantageous for the parties to agree that the quantity will not be determined until sometime after the parties enter into the contract. For example, the contract may provide that quantities are to be determined later by the contractor, depending on the orders it receives. This can serve several purposes (*e.g.* as a hedge against the uncertainty of future market demands and prices or unknown production quantities). This mechanism takes into account the general uncertainty that may affect agricultural production, but it also creates higher risks for the producer because the price to be paid could be lower than one potentially agreed at the time of the contract's conclusion. The producer should also be aware of the risk that quantities will fall below expectations because decisions to sow or plant must be taken months ahead of harvesting.

39. A contract that provides for the quantity to be determined later must provide some basis to determine both the quantity and the time when such a determination is to be made. Otherwise, the contract may be deemed too indefinite to be enforceable (see Chapter 2 at paras. 63-65).¹ A lack of a quantity term, in and of itself, may not invalidate the contract under many legal systems as long as there is some basis for

¹ For international commercial contracts, a similar rule can be inferred from arts. 2.1.2 and 2.1.14, UPICC.

determining a fair price.² Because a contract puts at least some minimal obligation on each contracting party, a purported agreement that gives the contractor unbridled discretion to determine how much, if any, of the production to purchase is likely to be deemed unenforceable under many legal systems.³ Specific regulations or codes of conduct governing agricultural production contracts, where they exist, usually include the indication of quantities in the list of required provisions. Sometimes, only certain types of terms to determine quantity are allowed. Certain regulations also provide for possible margins of tolerance.

40. But again, it may be advantageous to both parties to allow the contractor to have some level of discretion in the amount of production the contractor will acquire. To achieve this, the law typically provides various explicit and implicit terms⁴ to ensure that the contractor has some obligation, which at a minimum may require good faith and fair dealing. Past practices between the parties, as well as industry custom and trade usage, may also apply to limit the contractor's choice.⁵ It is also common for the parties to agree on an estimated minimum and maximum amount.

41. Whatever the method used to determine the quantities to deliver, contracts often stipulate that the produce must come from the producer's own production. Purchasing from third parties to be able to reach the required quantity is normally not allowed, as the goods must have been produced at the agreed upon location, using the inputs and methods provided for in the contract.

2. Quality

42. Under an agricultural production contract, producers are obligated to meet the quality standards provided in the contract and any applicable public regulations. In addition to the contract's express terms, the law may impose on the producer an obligation to ensure that the goods meet a general standard of merchantability and fitness for any particular

² For international commercial contracts, a similar rule can be inferred from Art. 5.1.7(1), UPICC.

³ For international commercial contracts, a similar rule can be inferred from Art. 5.1.7(2), UPICC.

⁴ For international commercial contracts, a similar rule is stated in Art. 5.1.7(1), UPICC.

⁵ For international sales contracts, a similar rule is stated in Art. 9(1), CISG.

purpose known to the producer.⁶ The obligation to meet the required quality standards may be an obligation that must be strictly adhered to depending on the contract's terms and the nature of the defect.

43. The producer must meet the quality requirements pertaining to both the process and the product, and the failure to meet them typically results in non-conforming goods (as discussed in greater detail in paras. 109-117 below). Product quality increasingly depends on process quality, so that, in contract practice, quality control at delivery is increasingly preceded by quality monitoring during the production process. Quality management systems (including the determination of policy objectives, planning, control, assurance and improvement of product quality) are required by various technical standards and sometimes by law.

(a) *Determining quality*

44. Quality requirements are often defined by different characteristics that can affect prices and even markets or distribution channels. For instance, the distinction within the same commodity between "high premium", "premium" and "standard" can translate into different prices and often different markets. These characteristics may include all physical characteristics (*e.g.* colour, size, shape), contents (*e.g.* low fat milk, seedless grapes) and fitness for a purpose (*e.g.* seeds which are resistant to a certain virus, asparagus clean of chemicals prohibited by the target market), as well as any process requirements. They may be based on the territory where production takes place and may include the denomination of geographical origin. The quality characteristics may be verified before the production process starts or at the final inspection when both quality and price are defined.

45. Product non-conformity can be evaluated not only against the express terms in the contract and those that apply by operation of law, but also in light of guidance, including technical guidance, given by the contractor and its agents (*e.g.* inputs provided by the contractor, process-related obligations set forth in the contract, required characteristics of the final product, technical assistance, capacity building and training to be provided to the producer).

⁶ For international commercial contracts, a similar rule can be inferred from Art. 5.1.6, UPICC and, for international sales contracts, is stated in Art. 35, CISG.

46. There are legal systems that impose restrictions on limiting liability, and therefore a clause that provides that the producer is solely responsible for the good's lack of conformity, and disclaims the contractor's liability to third parties for such non-conformity may not always be enforceable (see Chapter 5 at para. 6). Moreover, in some legal systems, it may be impermissible to shift the risk for defects to the producer when the defects are linked with contractor's instructions. Depending on the applicable law, the contractor's liability might be commensurate with the level of instructions given.

(b) Quality standards

47. Quality standards may be set out in the contract with a general formula or with more detailed specifications contained in an attached schedule or incorporated by reference to external standards. The parties are advised to pay sufficient attention to this aspect of the producer's obligations, but the degree of detail and the choice of criteria used will be related to the type of produce. Ways to define the required quality are not the same, for example, for potatoes, sisal or goat milk. When specifications are very technical, the contractor should ensure that the producer understands them. If necessary, appropriate explanations should be given when the contract is negotiated.

48. In practice, contracts are sometimes imprecise about the quality requirement. Some contracts, for instance, stipulate that the goods should be of "good quality", "the highest quality" or "acceptable quality". There seems to be differences of degree among these three formulas, but their vagueness is likely to be a source of difficulty in a dispute. Other frequent formulas refer to "merchantable" or "exportable quality", conformity "to international quality requirements", or "to requirements in the importing country". These criteria are also open to different interpretations.

49. Other contracts set forth precise and objective quality requirements. For instance, the produce's required characteristics can be stated in more specific terms (such as "a low-linoleic identity preserved grain", or "maximum moisture content 6,5 %"). A contract for the delivery of bee products, for example, can contain precise descriptions of the quality requirements respectively for honey, royal jelly and bee pollen. A contract for the supply of dairy animals can specify the accepted breeds, the maximum number of previous lactations of pregnant cows, and the minimum milk production of some animals during their previous lactation and the morphological defects that will

not be accepted. The contract can also provide a list of defaults that justify refusal of the goods.

50. A special appendix to the contract is a convenient and often used method for providing quality requirements when quality specifications are especially elaborate. One way to highlight the required quality standard's importance is to state clearly that the appendix is part of the contract. When quality requirements are expressed in charts that describe different grades or categories and the corresponding figures or percentages, it may be more conveniently done in a separate document than in the midst of a succession of various contractual clauses.

51. Referring to the standards set by an external source is another method for describing the required quality. These standards are often established by a professional association or enacted in domestic or international regulations. Contracts may for instance refer, if relevant, to the classifications, grades or other requirements set by different Governments, or to standards established by ministries or other public authorities. If the contractor is part of a supply chain where common quality standards have been defined, the contractor should ensure that the producer is adequately informed of the existence and contents of such standards. Private standards known as Good Agricultural Practices (GAPs) are defined as "practices that address environmental, economic and social sustainability for on-farm processes, and result in safe and quality food and non-food agricultural products."⁷ Incorporation of private standards like GAPs allows an assessment of conformity that takes into account the level of care and expertise that could be expected of a producer operating in a given field.

52. Specific regulations or codes of conduct that govern agricultural production contracts, where they exist, usually include an indication of quality as a required provision of the contract. Some regulations require specifications about size, weight, degree of maturity or juice content, the identification of the agency competent for quality dispute resolution, an indication of consequences for non-conformity, and that contractors ensure that the producers fully understand the required standards of quality. Some regulations require compliance with legal requirements, respect for animal welfare and the environment, the prohibition of

⁷ *Development of a Framework for Good Agricultural Practices*, FAO Committee on Agriculture, COAG/2003/6 (31 Mar. - 4 Apr. 2003).

genetically modified organisms, or promotion of local and biological products. Some jurisdictions have especially detailed provisions that regulate field sampling procedures. In addition to rules specifically designed for agricultural production contracts, more general regulations, as well as private standards, are often applicable to establish standards of quality. Quality requirements should be expressed in sufficiently precise terms to avoid subsequent disputes.

53. In agricultural production contracts, what constitutes fitness for ordinary purposes is mostly based on compliance with mandatory international agricultural standards, especially (but not only) if the produce is destined for international markets. These standards should preferably be referred to in the contract through express incorporation, bringing clarity and lowering any possible litigation costs (see Chapter 1 at paras. 45-48).

54. In many legal systems, general contract law provides default rules to define performance standards that would apply to agricultural product quality. One standard that may apply in some jurisdictions requires that the goods should meet the contractor's "reasonable expectations." At the international level, for instance, the general principle for sales contracts, in the absence of express quality standards, is that the seller must deliver goods that are fit for the purposes for which goods of the same description would ordinarily be used.⁸ The goods must also be fit for any particular purpose expressly or impliedly made known to the seller at the time of the contract's conclusion, except where the circumstances show that the buyer did not or could not rely on the seller's skills and judgment to pursue this purpose by using the goods.⁹ Apart from that, where the quality of performance is neither fixed by, nor determinable from the contract, a party may be bound to render a performance of a quality that is reasonable and not less than average in the circumstances.¹⁰

55. While default rules may fill gaps in the contract, the parties' interests are best served by clearly drafted clauses that provide for quality standards. This is particularly the case when the contract is international and the understanding of the default rules may vary between the

8 For international sales contracts, a similar rule is stated in Art. 35(2)(a), CISG.

9 For international sales contracts, a similar rule is stated in Art. 35(2)(b), CISG.

10 For international commercial contracts, a similar rule is stated in Art. 5.1.6, UPICC.

countries involved. For instance, there may be abundant case law or doctrinal sources on the meaning of “*merchantable*” under the contractor’s legal system (whether or not this is the law applicable to the contract), but the term may have no clear meaning to the producer. Terms such as “*merchantable*” could cause uncertainty and be the source of an unfortunate misunderstanding (for further related discussion, see Chapter 1 at paras. 35 and 45, and Chapter 5 at para. 63).

56. The producer and the contractor may set the extent of liability for product non-conformity by agreeing on disclaimers and limitations.¹¹ These may apply to limit the legal consequences derived from express description of the goods or from implied obligations under the applicable law that are not linked with agreed criteria to assess product conformity. For example, input providers sometimes limit their liability by excluding so-called consequential damages (*i.e.* damages that do not flow directly from the provider’s acts, but from the consequences of those acts). The validity of these clauses has often been challenged before domestic courts, and domestic legal systems differ on their enforceability (see Chapter 5 at para. 37).

(c) *Product safety*

57. Depending on the applicable law, both producers and contractors may have obligations related to product safety, such as ensuring traceability, avoiding or limiting the use of certain pesticides, or ensuring the hygienic conditions of livestock. Product safety is related to product quality and has long been a part of non-conformity evaluation.¹² Within the context of an agricultural production contract, product safety may relate to the prevention of hazards that can spread when the product is delivered to the contractor or that materialise only at the end of the process when the product is consumed or deployed for industrial use. Product safety affects not only the contractor but also those third parties that may be exposed to hazards without engaging in any transaction with the producer.

58. The parties’ ability to comply with safety standards depends largely on the risk assessment and management measures required by applicable law. The parties’ obligation to abide by safety standards could cover the

11 For international sales contracts, a similar rule can be inferred from Art. 6, CISG.

12 For international sales contracts, a similar rule can be inferred from Art. 35, CISG.

entire process. Remedies may differ depending on the time of risk detection and the availability of corrective measures (see Chapter 5 at paras. 56-57, 65-66, 106-109).

59. Packaging and labelling may greatly influence agricultural product safety. The availability of food information not only ensures a high level of consumer health protection, but also provides a basis for consumers to make informed choices and safe use of food. This function is even more critical when certification demonstrates compliance with standards. When the law establishes information rights for consumers, the duties deriving from these rights extend throughout the production chain whenever relevant information needs to be registered and reflected adequately on the packaging.

(d) Link with certification requirements

60. In some agricultural production contracts, the producer may have an obligation to become certified and maintain certification under a specific scheme. Certification and quality assurance schemes contribute to performance monitoring by the contractor and can facilitate early detection of conformity problems. If the producer is required to be certified, there is a link between the production contract and certification contract that results in potentially overlapping obligations in each. Assurance of compliance may be provided by the producer or the contractor jointly with a third party certifying body. In some cases, monitoring may take a two-step approach, whereby internal assurance is provided by the producer and external assurance by the certification body.

61. In the case of third party assurance for certification schemes, a certificate of compliance is normally provided to the compliant party. It may relate to the production site and methods, to the products as specifically examined, or to both the production site and the products. The certificate often comes with the right to use a logo or label to be shown on the product. Some of these labels are only aimed at being used in a commercial context and others are also used in “business to consumers” relations. The availability of certification may represent a valuable asset for market access. In many cases, contractors may require them as a condition for accepting the produce, whereas in other cases they only influence the final price without giving the contractor a right of refusal.

B. Production process

62. Agricultural production contracts typically set forth obligations on how the production process should be carried out, in particular for the producer but also for the contractor. Process-related obligations assumed by the parties vary greatly, and may have different levels of correlation with product quality and safety. For example, compliance with environmental standards may have a direct impact on the product, or be related to general sustainability concerns. This aspect will be particularly relevant when considering the available remedies in case of breach (see Chapter 5 at paras. 52-59, 86, 91-92). This section examines such process-related obligations.

1. Provision and use of inputs

63. Inputs encompass all physical (such as seeds, planting material or fertiliser) and intangible elements (such as technical assistance or training) that are incorporated into the final agricultural product's production. This section will first examine general obligations that are common in agricultural production contracts irrespective of the input type, and then will examine a few specific obligations related to certain input types.

(a) General obligations

64. The allocation of responsibilities for inputs between the parties varies. They are based on the contract's provisions, expressed and implied, as well as default rules from the applicable law and industry practices.

65. The supply of inputs by the contractor often allows the producer to engage in the production activity without having to finance the cost of the inputs up-front, which the producer might otherwise be unable to afford. Moreover, the contractor is also often in a better position to guarantee input availability, quality and costs. Particularly with large agribusiness contractors, economies of scale can keep the costs low by making larger purchases of inputs and granting credit to producers, and these savings can be passed on the producers and thereby reduce production costs. The contractor may also have ready access to mechanisation and transportation facilities that would not otherwise be available to the producer. Ideally, the combination of these factors should result in higher productivity and higher returns and thereby justify

the contractor's undertaking of these obligations. Conversely, though, the producer may be locked into the costs and quality of inputs from the contractor that do not reflect either the best price or quality available. If so, such a one-sided bargain may effectively reduce the producer's choices and call the contract's enforceability into question.

66. When the producer is to use the contractor's inputs, the producer may have to comply with several obligations. The first obligation is to receive the inputs. This obligation goes along with the corresponding rights to verify input conformity (*e.g.* keeping samples, keeping records) and to notify apparent defects (entailing possible remedies). Second, the producer may have an obligation to take care of the inputs. Depending on the type of obligation and the parties' specifications, this could be a far-reaching obligation, especially for risk of loss, against which the producer may be required to obtain insurance. Third, the producer may have an obligation to use the inputs according to the contractor's instructions. This may come with certain correlated obligations (*e.g.* observing necessary precautions in use; keeping records and complying with administrative obligations; using the inputs exclusively for purposes of the contract; returning unused inputs for credit as appropriate under the contract; and not diverting the inputs by selling them or using them for personal purposes). Conversely, the use of inputs from other sources is normally forbidden.

67. Producers may have an obligation to pay for inputs. Unless otherwise agreed (for instance by means of a deduction from the produce's final produce), all inputs that the producer has to purchase from the contractor, whether physical inputs or services have to be paid for. Because the input cost is often related to the payment for the goods, a well-drafted agreement will logically connect the input's description and pricing to the contract's overall payment terms so that all aspects of costs and payments can easily be compared. Failure to do so may subject the contractor to a different payment scheme based on default terms provided by the applicable law and not necessarily contemplated by the parties.

68. It would be in the parties' interest to have a price mechanism for inputs that promotes clarity, even though price can be determined by default rules. An express price term can have as much flexibility as necessary, and not only be set as a definite price, but also be based on subsequently determined market prices. Moreover, the price term for inputs can be individualised for each delivery or can be based on an

overall agreement. Absent an express term, there are various measures that can be used to determine input price (such as custom and trade usage, past practices between the parties, and the determination of a reasonable price based on appropriate market prices). For example, payment for inputs may be organised according to an agreed upon schedule, but very often, input price is deducted from the price due to the producer for the product's final delivery. The relationship between the input cost and payment for the production should be clearly articulated in the contract. The cost of input delivery can be borne by either party, but this needs to be provided for in the agreement. Some jurisdictions regulate input prices to prevent unfair pricing or violation of competition laws. These regulations are mandatory rules from which the parties may not deviate from in their contract.

69. The contract may require prompt payment of inputs supplied by the contractor. Very often, however, contracts do not provide for their immediate payment. The producer usually benefits from credit terms so that the price of these inputs will be deducted from the amount due by the contractor for payment of the produce after delivery. This amounts to an advance in kind received by the producer, reimbursable by reduction of the produce's final price. Inputs provided by third parties are normally paid directly to those suppliers.

70. It should be noted that inputs provided by the contractor may cause difficulties for the producer. These inputs may turn out to be defective (*e.g.* poor quality plants, infected seeds), thus preventing the producer from meeting the contractual quality or quantity requirements. Certification of input quality by an independent entity is sometimes advisable if it can be obtained. Contractor inputs may also be more expensive than similar inputs that the producer could purchase from another source. Problems also arise when the contractor is late in delivering the promised inputs, which possibly endangers the production process and the producer's ability to meet its obligations.

71. The contract may also oblige the producer to provide certain inputs. These physical inputs to be supplied by the producer may have to be bought from those inputs recommended or approved by the contractor. In addition, often the producer provides the land. When the goods are to be produced on the producer's land, contracts governed by some legal systems include a provision under which the producer represents that it is a legitimate holder of the land and that it has full title over the produce, or that no other party can assert rights over the

production (based, for example, on land tenure rights, security rights over the crop or otherwise, thus affecting its entitlement to the crop). By accepting such a clause, the producer would expressly or tacitly assume liability for all consequences that may derive from any misrepresentation on its part. If the producer is not the owner of the land, but leases it from a landowner, it may be advisable to require the landowner's signature on the contract, to avoid a subsequent claim by the landowner that the producer was not entitled to raise crops or animals on the leased ground.

72. Inputs may also be provided by third parties, and their failure to provide inputs or provision of defective ones may render one party liable to the other for output non-conformity or for breach of process-related obligations when such input non-conformity affects the production process.¹³ In the absence of a contrary contractual provision, the extent to which one party is liable to the other for production failure or product nonconformity resulting from insufficient or inadequate inputs supplied by a third party depends on whether the law will regard the consequences of the third party's failure as a risk falling within either party's sphere of influence or control.

(b) Specific obligations related to certain types of inputs

(i) Land, installations and fixed assets

73. In most agricultural production contracts, the contractor does not have rights in the land used for agricultural production, although in some limited circumstances, the contractor may provide or have an interest in the land and its fixed assets. Most often, however, it is the producer who provides the land, either as the owner or as the holder of rights when the land (or the aquaculture site) is owned by a third party. Sometimes, the state is the owner, and particularly in the context of public development programmes, contract farming will take place under public-private partnerships. Normally, in this case, a portion of the land would be directly managed by the contractor and contain the processing facilities. The remainder of the land would be allocated to the producers, who might be either individuals or communities working collectively.

74. If the producer leases the land, an important issue is the production contract's duration in relation to the lease (see further discussion in Chapter 6 at para. 10). If the lease is terminated or otherwise ends during

¹³ For international sales contracts, a similar rule is stated in Art. 79(2), CISG.

the production contract, the producer may not be able to perform its obligations. Secure land tenure rights are important for producers to build stable relationships with contractors and, in this regard, customary and traditional law may also have to be taken into consideration.

75. Many contracts require that production (or post-harvest operations) take place in certain facilities. The contract may specify detailed requirements or plans for facilities, particularly in livestock contracts (see further discussion in production methods, below at paras. 105-123). The particular location where the production takes place may be one of the produce's important attributes (for example when denomination of origin is relevant). Goods produced on a different tract of land than those specified in the contract would generally not be accepted by the contractor.

76. Some contracts require the producer to build a new facility or expand and improve an existing facility. These obligations are often accepted on the basis of some assumptions by the producer, including compensation by the contractor, which should be clearly delineated in the agreement. Of specific concern is whether the construction or expansion costs are only economically feasible where there is a multi-season contract between the contractor and producer. Whether articulated in the contract, a producer's normal expectations would be that the relationship with the contractor is going to be of a sufficient duration to make the facility construction or expansion economically viable (see further Chapter 6, at para. 4 and 35). These expectations, if not expressly provided for, would normally be implied as part of the contract.

77. Other ancillary obligations of the contractor may include any of the following: assurances for third-party financing of facilities; meeting deadlines or paying penalties for late performance if the contractor is responsible for construction; ensuring adequacy of design and providing warranties for defects if the contractor supplies the design or labour; guaranteeing that the facilities meet industry standards and Government regulations; or ensuring Government approval and permits.

(ii) Physical inputs

78. The contractor generally has a major role in input selection. There are various ways for the contractor to supply or control them. For example, the contractor may supply the inputs directly or the contractor may provide the producer with technical specifications or the input

brands that the producer may buy and use. The contract may require the producer to obtain certain inputs from a third-party supplier. Although the contractor may supply a significant amount of physical inputs, the producer generally provides the land, physical facilities, water, energy, and labour.

79. Domestic law may provide default rules for the supply of inputs. For example, unless otherwise agreed by the parties, the contractor may have a duty to provide seeds and the necessary technical assistance for production. These default rules may normally be modified by the parties.

80. If the contractor has the obligation to deliver inputs, the contractor must deliver inputs that conform to contractual specifications. This obligation not only includes conformity with the contract's express terms, but also generally requires that the inputs be fit for the ordinary purpose that inputs of that type are used.¹⁴ The law may also provide an obligation that the inputs are also fit for any particular purpose beyond the ordinary use if the contract requires such a use.¹⁵ Whether the contractor can disapply obligations beyond these implied obligations flowing from the applicable law varies among different domestic laws. When the contract requires the producer to obtain inputs from specific third parties, the contractor has an obligation to ensure the appropriateness of the inputs.

81. If the contract specifies how the inputs that the contractor supplies are to be used, the contractor normally bears risks from non-performance due to faulty instructions.¹⁶ Unless the producer, by experience or otherwise, has specific knowledge about the proper usage of the inputs, the contractor generally has the obligation to supply this information or other technical assistance. For example, because feed quality and quantity are essential to production success, if the contractor is to supply the feed, the contractor is responsible for its quality and appropriateness. It is also important to clarify not only the contractor's obligation to supply feed, but also obligations for storage, drying, processing, trucking and other handling costs. As with many contractor obligations, this requirement is multi-layered. Not only must the contractor meet the direct obligations to the producer, the contractor must also consider the

¹⁴ For international sales contracts, a similar rule is stated in Art. 35(2)(a), CISG.

¹⁵ For international sales contracts, a similar rule is stated in Art. 35(2)(b), CISG.

¹⁶ For international sales contracts, a similar rule can be inferred from Art. 35(2)(b), CISG.

feed's suitability and acceptability in relation to subsidiary obligations owed to buyers down the value chain, as well as Government regulations and industry standards. Moreover, even if the contractor is not directly responsible for supplying the feed to the producer, these secondary obligations may require the contractor to monitor the feed used by the producer to ensure compliance with the contractor's other contractual, industry and regulatory obligations.

82. In addition to any input obligations on the contractor, there may be ancillary obligations the contractor has to perform. If the contractor specifies the inputs, in addition to satisfying the contract's terms, the contractor will normally be expected to comply with applicable Government product and safety regulations. For example, with livestock, the contractor is normally obliged to have the animal's health certified in accordance with Government regulations and, if required by law, to obtain such a certification from the appropriate Government officials. These certification standards may be imposed not only by Government requirements, but also by industry requirements (see Chapter 2 at paras. 54-55). The contractor may also be responsible for liability and casualty insurance on the livestock. Moreover, because livestock usually belongs to the contractor, the contractor may be responsible for providing medicine and veterinary services. The party responsible for removing dead animals should be specified in the contract, but as with some other obligations, the applicable law may impose upon the contractor to guarantee that such removal is done safely according to health guidelines. Also, the contractor may have health and safety obligations extending throughout the distribution chain. Veterinary medicine is subject to, and therefore must meet, various Government regulations, industry standards and labelling requirements throughout the distribution chain. It should also be understood that these obligations exist irrespective of whether the contractor is responsible for providing this input, and therefore the contractor will have an obligation to monitor any medicine in order to meet its own Governmental and distribution chain obligations.

83. Furthermore, the contractor may have other potential legal liability to the producer and possible third parties. First, to the extent that the contractor owns or supplies the inputs, the contractor may have tortious liability for harm caused by the inputs to the producer and foreseeable third parties. This, for example, could result from the supply of defective seeds or other inputs (such as fertiliser and herbicides). It is important to note that the contractor would rarely be able to contract out of possible

tort liability. Moreover, the contractor may also be subject to Government sanctions if the inputs do not conform to applicable Government regulations (such as those regarding use of genetically modified crops). This liability, which is outside the contractual relationship between the contractor and producer, is not subject to any exclusions or limitations in the contract between them (see Chapter 5 at para. 6).

84. The time of input delivery typically affects the producer's ability to meet the production requirements. It is therefore advisable to provide express terms in the agreement for the time and place of input delivery, as well as the consequences of untimely delivery (*e.g.* price and production adjustments).

85. Some flexibility for the timing of input deliveries may be desirable to take into account contingencies (such as weather). It may also be common in certain industries to provide for this flexibility as a matter of custom. This will typically be the case in husbandry production contracts that generally provide the contractor with a certain flexibility (*e.g.* for new deliveries of young animals after preceding ones have been taken over; for cleaning the facilities; for ensuring adequate and safe veterinary conditions). This may be stated in general terms (such as requiring "timely delivery"). Even if this is not expressly provided, it may be read into the contract.

86. The contract may provide that the inputs be subject to a verification procedure at the time of delivery (for example the weighing of young animals), which may be carried out in the presence of both parties or a third party. This obligation may arise from the contract's express terms, by trade usage and custom, or in some legal systems, by the general obligation of good faith and fair dealing.

(iii) Financing

87. Some agricultural production contracts incorporate financing, either directly by the contractor or by third parties. This financing may take several forms. For example, the contractor may agree to provide cash advances or even loans to the producer. The producer usually undertakes to pay for the contractor's inputs, but this payment often benefits from credit terms, with an agreement that the price of inputs will be deducted from the final amounts due by the contractor to the producer after delivery of the goods. These and other types of financial

assistance are also often reimbursed by way of a deduction from the final payment.

88. Advance payments on the price to be paid for delivery of the contractual produce are often essential for the producer to cover costs incurred in production, and the contractor may require that advances be used specifically for that purpose (rather than for personal or household use). Advance payments may be granted at different times. They are often made after the contract has been concluded, to finance the whole production process, but they can also be more limited in amount and be paid a few days before harvesting, to finance the specific costs of the final operations leading to delivery. These advance payments normally are deducted from the final price to be paid for delivered produce. Another form of assistance may consist of credit lines for purchase of inputs.

89. These different forms of financing are granted sometimes without, but usually with, interest charges (in systems where paying interest is recognised). Paying interest, where applicable, is another obligation undertaken by the producer. The contractor generally deducts the interest from the final price due. The contract should clearly spell out the interest rates and other possible costs associated with financing. A contractor may request that the producer provide a personal guarantee for the full amount of the debt (as could be the case when the producer enjoys limited liability as a corporation), provide a third-party personal guarantee, or grant a pledge over the land.

90. Advances may account for a large part of the future amount payable upon product delivery. If advances are uncontrolled, though, producer indebtedness can increase to unsustainable levels. The contractor may have an obligation under the applicable law to ensure that the producer has a reasonable likelihood of paying off the loans and advances.¹⁷ Correspondingly, parties to an agricultural production contract should know that many legal systems regulate certain forms of credit to protect the borrower. Regulations or codes of conduct specifically concerning agricultural production contracts, where they exist, may require financing arrangements in the list of required contractual provisions (*e.g.* identification of the financier, amount,

¹⁷ For international commercial contracts, a similar rule is stated in arts. 5.1.3. & 5.1.4, UPICC.

purpose, duration, interest rate where applicable, costs, reimbursement schedule, security).

91. Advances made by the contractor may be significant, just as the risk of default by the producer. The contractor would assess the risks based on the relationship's nature and history, the producer's creditworthiness, the protections available under the legal system and the effectiveness of enforcement mechanisms. For informal operations that involve individual small producers, contractors normally rely mainly on personal relationships and trust. Under formal operations, however, they generally seek to cover non-repayment risks through insurance or a security interest. In some legal systems, an agricultural inputs supplier is entitled to either a general or a special lien over the crop, which may be subject to filing formalities.

(iv) Services

92. The contractor may provide various services to the producer on potentially every production aspect (such as soil or facility preparation or technical assistance). Such services may also assist the producer's performance and improve its capability. A clear distinction cannot always be made between the two categories, and the services provided may often be considered as part of the contractor's oversight in directing the production.

93. Technical assistance is typically one of the services provided by the contractor. Technical assistance may involve specialised or expert support consisting of, for example, agronomic or veterinary assistance. In addition to the standard of performance set out in the contract, technical services may also be subject to standards of performance provided for either by Government regulation (particularly in the area of safety) or by recognised trade or professional standards of conduct. These standards become part of the agreement either as mandatory rules or by implication. When the producer lacks the required knowledge for the proper use of specific required inputs, the applicable law may oblige the contractor to provide technical assistance in the inputs' use (such as feed and medicine).¹⁸

¹⁸ For international commercial contracts, a similar rule can be inferred from arts. 5.1.3. & 5.1.4, UPICC.

94. In performing a particular service for the producer, the contractor is subject to standards of performance that may be specified in the contract. Particularly relevant factors in determining the obligation's nature, extent and standards of performance, include the contractual price and other contractual terms reflecting the allocation of risks and balance of obligations; the degree of risk normally involved in achieving the expected result and the other party's ability to influence the performance of the obligation.¹⁹ A contractor providing extensive technical advice may seek to limit their exposure to the risks of production loss resulting from ineffective advice by disclaiming liability for the consequences of the advice given. Not all legal systems, however, permit such a waiver of liability (see chapter 5 at para. 6)

(c) Obligations related to intellectual property rights

95. Both producers and contractors are well advised to consider possible obligations related to intellectual property rights (IPRs) over inputs and the final agricultural produce. IPRs may be held by the contractor or by third parties. Genetic resources as encountered in nature are not covered by IPR protections; they are not creations of the human mind and they cannot be directly protected as intellectual property. However, inventions based on or developed using genetic resources may be legally protected. Thus, contractors may not only own the physical seeds or other inputs that they provide to producers, but contractors may also own or have licenses for IPRs to inputs which are protected by patents, plant variety rights, registered trademarks, trade secrets or geographical indications. Generally, they may impose on sellers of goods a legal obligation to indemnify the buyer against the infringement of IPRs, and that the sold goods are free from any third parties' IPRs within certain territories, and within certain limits.

96. In general, when the inputs or the technologies included in the inputs are patented, producers will have an obligation to refrain from producing, using, offering for sale, selling or importing the patented products without the patent holder's consent during the protection period. If the inputs are protected by plant variety rights, producers are usually excluded from production, reproduction, propagation, offering for sale, selling or other marketing, exporting, importing or stocking of the protected variety for any of the purposes mentioned above without

¹⁹ For international commercial contracts, a similar rule is stated in Art. 5.1.5, UPICC.

the patent holder's consent during the protection period.²⁰ Most countries have rules that regulate or limit the conditions under which producers may save (for replanting) any seeds protected by plant variety rights.

97. If the inputs are protected by registered trademark, producers are excluded from attaching to those inputs the mark that usually stands for those inputs. Trademark registration is usually renewable, so the protection will last as long as the trademark holder pays the annual fees. If the inputs contain trade secret information, producers will have an obligation to keep such information confidential and prevent it from being disclosed to, or acquired or used by others without the rights holder's consent.²¹

98. The concept of intellectual property rights licensing and the content of IPR licensing clauses included within an agricultural production contract are very important for determining the parties' obligations. A licensing agreement is "a partnership between an intellectual property rights owner (licensor) and another who is authorised to use such rights (licensee) in exchange for an agreed payment (fee or royalty)." In an agricultural production contract, the contractor may be the holder (licensor) of IPRs or the input supplier under a license from a third-party IPR holder. Thus, with certain types of inputs, the contractor's IPRs may impose special obligations on producers, as well as related obligations upon the contractor.

99. The agricultural production contract may contain so-called "warning clauses" forbidding the producer from using seeds for planting other than a single designated crop, from transferring or reusing seeds for replanting and from revealing confidential information. The contract may also oblige the producer to pay a technology fee. To avoid mixing between crops, the contract may further require the producer to keep seeds separate, to mark and clearly identify the borders of the fields where the seeds have been sown, or to abstain from allowing third parties to grow identical products on the same land. If animals are provided, the contract may require the producer to take appropriate

²⁰ See Art. 14, International Convention for the Protection of New Varieties of Plants (1991).

²¹ See Art. 39, Agreement on Trade-Related Aspects of Intellectual Property Rights (1994) (TRIPs).

measures, such as fencing (to prevent intrusion of other animals), or to abstain from raising other animals on the same premises.

100. Some contractors require that producers purchase the proprietary seeds and traits under license, or acquire them as forwarded inputs. This has consequences, for example, for determining whether the producer is entitled to use the crop as collateral. Producers who do not understand these implications, or choose to ignore them, may face unexpected obstacles or serious penalties.

101. Often, a third party will hold IPRs over inputs used under an agricultural production contract. Accordingly, the contractor may sometimes provide representations on non-infringement of IPRs held by third parties. Under this type of clause, the contractor will compensate for losses incurred from the infringement of third parties' IPRs even if the losses occurred on the producer's production site. Also the contract may specify which party must act in the event of legal proceedings initiated by third parties for IPR infringement. This functions to minimise the risk of infringement of third parties' IPRs.

102. When contractors are licensors of IPRs to producers, several different types of clauses may be included to attempt to protect the licensor's rights. Contractors may sometimes insert a clause stating that the producer (licensee) cannot use the IPRs beyond the geographical limitation of the license. Some contracts include a clause whereby the contractor (licensor) can terminate the contract if the producer (licensee) files a petition for the invalidation of the IPRs that are the subject matter of the license. Contractors (as licensors) sometimes insert into the contract a clause whereby the contractor is not required to reimburse the licensing fees paid by the licensees, even if the IPRs which are the subject matter of the license are declared to be void. IPRs present special considerations for remedies in the event of breach by the contractor, for example, when producers as licensees want to sell their products if a contractor fails to perform by buying them. In view of exclusivity clauses and the contractor's IPRs, however, it is possible that the producer cannot sell those products to third parties.

103. In addition to the obligations mentioned above, the contracting parties may be obliged to perform some duties even after the contract's termination. For example, the duty to keep trade secrets confidential may continue to exist. Contracting parties are well advised to include a clause that both parties must maintain trade secrets even during dispute resolution procedures. This issue becomes particularly sensitive when a

dispute proceeds to litigation before a State court. The parties may have to submit evidence that could potentially contain trade secrets or other confidential information. Here, domestic laws may include relevant provisions about confidentiality in the litigation procedure as a limitation to the principle of openness of judicial proceedings.

104. Generally, the subject of IPRs is an aspect of the contractual relationship in which the contractor will be well aware of its rights and one in which the producer may not fully understand all ramifications. For example, when a contractor is the IPR holder, the contractor will sometimes require producers that receive protected seeds as inputs to agree to “seed-wrap” or “bag-tag” licenses printed on or attached to a bag of seed, or to sign a “technology agreement” when purchasing seed, which prohibits producers from reselling the seed or supplying it to anyone else for planting. In some cases, such a situation may impose an obligation, either expressly stated in the agreement or by implication, on the contractor to ensure that the producer is fully apprised of its obligations.

2. Production methods, compliance and control

105. Complying with quality obligations at delivery often requires complying with specific methods during the production process. Food products and food production are subject to mandatory regulations that reflect public policies for food safety and quality control for consumer, worker and environmental protection. There may be applicable regulations regarding production facility conditions, the protocols to be followed in production, and the handling to guarantee the product’s safety and integrity. Participants in the distribution chain are generally required to keep appropriate records that establish the product’s condition and compliance with the required processes at different times of the production, transformation and marketing, thus ensuring the product’s traceability along the chain and providing evidence of the product’s conformity throughout distribution.

106. Operators in the food industry have developed a wealth of private standards regarding particular attributes, qualities or geographical origin of a product or category of products, processes or production management systems. Compliance with standards generally involves substantially higher production and management constraints and costs, but may be an opportunity to obtain higher market value and competitive advantages. In any event, obtaining a licence or a

certification regarding good agricultural practices may be a prerequisite to selling on specific markets and required by the buyer before entering into a contractual relationship. From the contractor's perspective, subjecting the producer to certification is an important means of exerting control over the production. Often, the contractor is the party seeking the certification, based on its participation in a supply chain identified by a particular mark or label, and would seek to apply that requirement to the product or production process in the contracts with producers. In such a situation, the contractor usually bears the certification costs.

107. Producers may also be the initiators of a particular certification scheme provided they can afford the organisational, technical and cost implications. Particular schemes aim to facilitate access to certification services through the support of Government agencies, non-profit institutions such as universities or non-governmental organisations, sometimes involving public subsidies paid to farmers to meet certification costs, or alternative certification systems for small farmers. Certain schemes allow for group certifications, whereby a group formed by various participants (for example several producer organisations) will apply internally the control procedure required to meet those standards, and will in turn be inspected by the certification authority (involving collective responsibility in case of individual member failures).

108. Certification plays an important role for the agricultural production contract and its parties in several ways. Certification provides evidence and legal certainty about contract performance. It serves as a tool for monitoring risks and improving performance and enables a proper allocation of liabilities in case of non-performance, thus contributing to lessen the risks incurred by the parties. When irregularities and infringements are found, the certifying body may be entitled to apply a series of measures, from corrective instructions to sanctions, that may lead to certification denial or withdrawal, which has implications for the available remedies under the production contract.

(a) Specified production methods

109. Most agricultural production contracts oblige the producer to follow the methods prescribed by the contractor, in addition to any mandatory obligation to comply with safety, environmental or social standards under the applicable law. The contract may require that the producer comply with certain quality standards (for example stricter requirements of the importing country), or corporate social responsibility principles (for example principles regarding respect of human rights

related to labour, including working conditions, non-discrimination, freedom of association, right to collective bargaining) (See Chapter 1 at 58-61). The producer may also be bound to undertake several practical operations related to growing crops or raising animals, involving the provision of services and goods. Certain operations may be ancillary to the production itself and may relate to the post-harvest period for crops (*e.g.* sorting, grading, packing, transporting, before or at delivery).

110. The obligations may either be express, with the contractor's detailed requirements for the production process, or they may be implied obligations stemming, when recognised by the applicable law, from the nature and purpose of the contract, the practises established between the parties or usages, good faith, fair dealing or reasonableness,²² together with the possible relevance of good practices and codes of conduct. The producer's obligations are either to deliver a particular result,²³ or to apply its skills, diligence and best efforts to that end.²⁴ Several considerations may be particularly relevant to distinguishing between one or another situation, such as the way the obligation is expressed in the contract; the contract terms, in particular the price; the degree of risk normally involved; or the other party's ability to influence the performance of the obligation.²⁵

111. The contract may require the producer to cooperate with the contractor to ensure compliance with the production method and to avoid incidents. For example, it may be required to ask for instructions, advise on problems occurring (such as animal disease or delays in the production), or provide monitoring reports.²⁶ The applicable law may even impose such obligations. The obligation to comply with the contractor's instructions is sometimes only expressed in a general formula in the contract itself. This may not always be advisable, as it may expose the producer to obligations that it did not have the opportunity to discuss and fully understand before entering into the contract. A more explicit formula can list the different aspects on which the contractor's

22 For international commercial contracts, a similar rule is stated in Art. 5.1.2, UPICC.

23 For international commercial contracts, a similar rule is stated in Art. 5.1.4(1), UPICC.

24 For international commercial contracts, a similar rule is stated in Art. 5.1.4(2), UPICC.

25 For international commercial contracts, a similar rule is stated in Art. 5.1.5, UPICC.

26 For international commercial contracts, a similar rule can be inferred from the general duty of cooperation as stated in Art. 5.1.3, UPICC.

instructions have to be followed. This listing draws the producer's attention to the wide range of instructions that it must follow, but still leaves much uncertainty about their specific content.

112. The contract often specifies the time when planting or sowing can take place. When appropriate, provisions require rotation in the uses of cultivated lands. Irrigation and drainage may be necessary to ensure crop success and quality. Contractors often specify the techniques to be followed by the producer. Furthermore, agricultural production contracts frequently contain provisions dealing with the use of fertilisers. Sometimes fertilisers are provided by the contractor and the contract may specify that they may not be used for other crops. Otherwise, the producer is generally obliged to buy types recommended by the contractor. Some elaborate requirements may govern the fertiliser use. Very detailed instructions concerning their application appear in some contracts, often located in a specific appendix at least several pages long (*e.g.* preliminary soil test, types and combinations of fertilisers to be used, frequency of application, quantities, soil preparation for the applications). Sometimes a more general formula is used. Directions concerning production methods usually oblige the producer to take adequate measures for weed and pest control. Before entering into a contract, producers are well advised to become aware of the risks and benefits of the use of pesticides and other chemical products, considering their possible environmental impact. Instructions on production methods given by the contractor generally include provisions requiring the necessary precautions. The contract may, for instance, forbid the use of herbicides for weed control, or the use of chemicals and pesticides banned by applicable regulations or not admitted by the contractor. Some contracts contain a specific exhibit listing accepted pest control products and giving directions for their use.

113. Harvesting is a key moment in the production process, and contracts usually specify that the producer must harvest all produce in accordance with instructions given by the contractor, and often under its supervision. Special training is sometimes provided shortly before the harvest. The time for harvesting is often determined by the contractor; however, some cooperation with the producer and a degree of flexibility are advisable, because the proper time is largely dependent on the crop's state of maturity and the weather conditions. The contractor's presence during harvesting is sometimes required by the contract. Some contracts also contain directions about post-harvest practices, such as cleaning the

produce to wash off soil and possible contaminants, or taking appropriate care of the harvested field (*e.g.* by removing plant roots and stalks).

114. Livestock and poultry contract production have specific requirements for production methods. Among the typically specified obligations, the animals, usually supplied by the contractor, have to be housed in adequate facilities containing the necessary equipment and comply with prescribed standards regarding size, sanitation, temperature or litter. Sufficient water needs to be available for drinking and cleaning. Directions for pasture management are also frequently provided. Whether food and medicine are supplied by the contractor or purchased by the producer in conformity with the contractor's specifications, the producer undertakes to apply the required standards for feeding and medication. Particular rules may govern the producer's obligations when animals are born or "terminated" for consumption, as well as for disposal of animals that have otherwise died. Collection methods for animal produce (such as milk or honey) are also frequently subject to detailed contractual provisions.

115. In the context of some particularly complex agricultural production contracts, the producer may be required to ensure the product's traceability by law, by private standards (such as ISO 22000),²⁷ and sometimes by contract. Traceability is defined as "the ability to follow the movement of foodstuff through specified stage(s) of production, processing and distribution."²⁸ Product traceability includes information about compliance with quality and safety requirements throughout the distribution chain. Traceability is essential to facilitate the adoption of corrective measures where hazards emerge at the production or consumption stage and helps to prevent the effects of non-compliance from spreading along the chain and within several lines of production.

116. Agricultural production contracts may contain provisions on labour and hygiene. A clause in the contract may state that the producer is responsible to hire "sufficient and efficient labour" or to comply with mandatory labour standards. The ban on child labour is often specifically

²⁷ The International Organization for Standardization (ISO) has established standards for a certifiable food safety management system, identified as ISO 22000. For more information about the ISO and ISO 22000, see <http://www.iso.org/iso/home/standards/management-standards/iso22000.htm>.

²⁸ Definition adopted by the Codex Alimentarius Commission at its 27th Session for inclusion in the Codex Procedural Manual.

expressed. Some contracts contain provisions on hygiene conditions that the producer must maintain during the whole production process (*e.g.* hygiene of the people handling the produce, animals, containers, storage places, and means of transportation). On a related note, regulations of a general nature (*i.e.* not specifically devised for agricultural production contracts) may also apply to some aspects of the producer's obligations for methods of production. Most agricultural products, as well as methods of production, are subject to regulations for health and safety. Environmental regulations may also affect such methods.

117. Industry codes of conduct, where they exist, often encourage the parties to include the requested methods of production in the contract. Some regulations go further, entering into details in many respects (such as pesticide use, demanding compliance with rules concerning environmental or labour matters, or again prohibiting compulsory purchase of inputs at prices above reasonable market values). Sometimes, the requirement is expressed that special production or livestock handling methods, if imposed, have to be clearly explained to the producer.

(b) Monitoring and control

118. Agricultural production contracts often provide that the contractor's representatives or authorised third parties, such as a certifying agent, will have access to the production site, partly to give direct advice and partly to supervise the way the prescribed methods are implemented. Sometimes this is listed among the contractor's obligations. While the producer must allow these visits, the contractor may also use them to give additional direct advice. If the right to visit the production site is not stated explicitly in the contract, the contractor's right would normally be implicit in the right to verify the production process.

119. Reasonable access to the planting areas is necessary for the purposes of these visits, and the right to enter the premises is often spelled out explicitly. Many contracts have more particular terms to ensure free access (for instance specifying that the rights of inspection extend not only to the crops, but also to harvesting equipment, transportation vehicles and storage facilities, or to the food and medicine to be given to animals). There may also be specific requirements for the accessibility of paths and plots. It is also common to provide for the conditions of the visits (such as the frequency, hours, advance notice to be given, and the recording of the visits).

120. While the contractor may wish to reserve the right to visit the site at any time without prior notice, the producer may prefer to receive at least some advance notice, in order to make proper arrangements for the visit and coordinate it with its own work schedule. The requirement of advance notice is sometimes stipulated. The visits should take place, as many contracts specify, at “reasonable” times. More specific contractual terms regarding visits are possible as well (such as specifying that visits are possible for specific operations (*e.g.* harvest) or may be more frequent depending on the growth stage).

121. Commonly, the terms that provide for the contractor’s supervision of the production are standard terms in form agreements, *i.e.* terms that are not individually negotiated. Frequently the contractor provides guidelines or a manual that relates to the production or the contract refers to such materials.

122. When the contractor exercises broad control over the production, as part of the parties’ general expectations, best practices of contract farming may impose on the contractor a duty to help the producer meet its contractual obligations and avoid unnecessary risks. Moreover, there may be a general duty of cooperation implied in the agreement²⁹ that imposes the obligations of fair behaviour, timely and diligent actions to support the producer’s performance, communication of relevant information and informed advice. However, if the extent of the contractor’s control over production interferes with the producer’s independence, the producer might not be viewed as an independent contractor but as the contractor’s employee (see Introduction, at paras. 43-46).

123. Apart from occasional or periodic visits, the contract sometimes provides that key operations such as planting and harvesting will take place in the presence of a representative from the contractor. In these cases, the contractor may have an obligation to see that its representative is present in due time, as the operations at stake cannot be delayed. When the contractor uses third parties for inspection, the contractor is responsible for its agents and has an obligation to ensure compliance with objective and verifiable results. Where the contractor has higher knowledge than the producer, the contractor may have a duty to alert the producer about any breach of mandatory obligations under the law (such

²⁹ For international commercial contracts, a similar rule is stated in Art. 5.1.3, UPICC.

as those under labour or environmental law). This obligation would generally impose a duty on the contractor to assist the producer in correcting the defect.

C. Delivery

124. Delivery is a key moment in the contract's performance. The contractor's obligation to take delivery of the goods and the producer's concomitant obligation to deliver the goods are basic and mutually dependent obligations in any agricultural production contract. The obligation of delivery may also be the source of important legal effects such as passage of title or transfer of risks. The contractor may also lose its right to exercise remedies for apparent defects if it does not make appropriate reservations upon delivery. Absent agreement to the contrary, the producer's delivery is necessary to trigger the contractor's obligation to pay the price.³⁰ When ownership of the goods is to be transferred under the contract, delivery does not necessarily indicate that title to the delivered goods has been transferred.

125. Taking delivery includes several acts that are relevant to assess not only the producer's liability but also the contractor's liability. Taking delivery entails: (a) taking possession; (b) inspecting the goods; and (c) accepting or rejecting them. These activities may be seen in light of the duty to cooperate by enabling the producer to perform its obligations. A failure to take delivery may exempt or reduce the producer's liability. In addition, this failure may increase the costs of performance borne by the producer.

126. Most domestic contract laws have default rules for the time and place of delivery.³¹ However, it is unusual in an agricultural production contract for the parties not to agree on these terms, either expressly, by past performance, or by custom and trade usage.³² As a matter of good practice, the different aspects of delivery should be organised by appropriate provisions in the agricultural production contract. Some contracts fail to do so, or they address delivery matters in insufficient

³⁰ For international sales contracts, a similar rule is stated in Art. 53, CISG.

³¹ For international commercial contracts, a similar rule is stated in arts. 6.1.1 & 6.1.6, UPICC.

³² For international commercial contracts, a similar rule is stated in arts. 4.2 & 4.3, UPICC and for international sales contracts in Art. 9(1), CISG.

detail, which is likely to cause difficulties. Clarity about this important phase of contract performance is essential to ensure orderly performance and discharge of the parties' obligations. It is also advisable to avoid clauses that allow one party to determine unilaterally the conditions of delivery. The producer may be required to perform all the acts that may be reasonably expected to enable the contractor to take delivery.³³ The producer is under an obligation to take care of the goods pending the actual taking of the goods by the contractor.

127. Most legal regimes have default rules on risk of loss, which generally apply to agricultural production contract. For example, if delivery is at the production site or at another agreed location, the contractor must normally collect the goods at the contractor's own risk and cost. Given the myriad of factors that often accompany the delivery (such as inspection before or after delivery, quality certification, weighing, grading and packaging), the default rules often do not match the parties' expectations. Therefore, it is advisable to deal expressly with these matters in the contract.

1. Time and place

128. Setting the time for delivery can consist of fixing a provisional date, an ultimate date, a time, a series of dates or a period in the contract, depending on the time when the produce is expected to be harvested or collected. Delivery at the wrong time or place can result in product deterioration and possibly monetary losses arising from the resulting breach of other contractual obligations between the contractor and an entity further along the supply chain. Considering the uncertainties of future weather conditions, it may be difficult to anticipate precise dates in advance. If a definite delivery date is not set, the contract should provide a method for setting the delivery date in the future. The contractor usually reserves the right to set the dates. Less frequently, it is up to the producer to provide the time of delivery. Another option is to provide that delivery dates will be mutually agreed. It is also possible to set a date in advance, but to stipulate that this date is subject to variation, either at one party's initiative or, preferably, by mutual agreement. The contract may be more precise, and specify the hours of the day when delivery must take place.

³³ For international sales contracts, a similar rule is stated in Art. 60, CISG.

129. Whereas the contractor may tolerate minor delays, delay in delivery is normally considered a form of contract breach. Compliance with a delivery schedule is very important in the case of goods that deteriorate rapidly, whereas it may be of minor importance in the case of (some) livestock or forestry.

130. The contract should indicate the place of delivery. It may require the producer to deliver the goods at the contractor's premises, or at the location indicated by the contractor (for instance an elevator, a collection centre or a warehouse). However, it also occurs that the contractor undertakes to take delivery at the producer's premises, which in many cases (such as livestock) may be a preferable option for the producer, as it shifts the risk of loss during transport to the contractor. Special provisions may then oblige the producer to ensure access to the place where the goods are located, or to see that the place is suitable for loading. Some contracts attempt to be very precise about the moment delivery occurs at the indicated place.

131. The goods have to be transported from the place where they have been harvested or produced, sometimes first to a storage place, and in any case to the delivery point. The contract will specify which party is responsible for transporting the goods, and who will bear the costs. Sometimes the producer has to organise transport, whereas sometimes the contract provides that the production will be transported in vehicles hired by the contractor. It can also be agreed that the contractor will hire carriers on behalf of the producer. As for costs, a contract may, for instance, specify that the cost for the short-distance transportation to a temporary storage point will be borne by the producer, while the cost of transportation to the delivery point will be borne by the contractor. Other allocations of transportation costs are of course possible and the cost of transportation to the place of delivery is also often borne by the producer. In addition, it may be useful to specify in the contract who will be responsible for loading and unloading the goods.

132. Delivery may implicate numerous types of post-harvest operations, each of which may entail an obligation on one or both of the parties. For example, quality control will often require produce grading according to the contractor's requirements or applicable standards or regulations.

133. Before delivery, the produce has to be packed in an appropriate way. Contractors often stipulate requirements on this subject. The contract may provide that the containers have to be labelled with a specified distinguishing mark, if only to distinguish them from those

belonging to another production. Directions about packaging may also be concerned with preventing the practice of over-packing. Some contracts require that packing take place in the presence of a contractor's representative. Packaging may also be governed by certain norms. The containers may have to be purchased by the producer; sometimes the contractor provides them. The contract should clarify which party bears the cost. If the containers have to be provided by the contractor, the contract should provide for their timely delivery before the harvest, in the right quantity.

134. If the produce needs to be stored before delivery, the contract should specify the conditions of storage. General requirements may be set for sanitary conditions, temperature, moisture, protection against natural elements (*e.g.* sun, rain), or safety. Directions can be given about the storage locations (*e.g.* the presence of shelters close to growing plots). It is common for warehouses and similar entities to participate in the sorting, packaging and labelling of the goods. If, as between the producer and contractor, the contractor has the obligation to package the goods, the warehouse will effectively be the contractor's agent and not relieve the contractor of responsibility for safe packaging and storage.

2. Acceptance

135. The producer is obliged to enable the contractor to inspect the goods at delivery but the contract may also oblige the contractor to inspect them promptly. This is particularly important for commodities that deteriorate rapidly (sugarcane, for instance, loses its saccharose in about three days after harvesting). Moreover, when goods inspection is due to occur after taking delivery (rather than before, *e.g.* at producer's premises), delay in taking delivery may cause a delay in inspection. This may alter the inspection outcome and therefore hinder assessment of the producer's liability, and may be grounds for exempting or limiting the producer's liability depending on the applicable law. If the truck has to wait in long lines for several hours in front of the mill before delivery can take place, the producer may suffer losses in the form of a price reduction or even refusal of the goods. It is in the producer's interest to be informed, without undue delay, that the goods have been accepted (or that problems have been detected). It is also important that the goods be examined in the condition in which they have been delivered, without being affected by their subsequent conditions of handling and storage by the contractor (or by their possible natural deterioration with the passing of time, such as weight loss).

136. Quantity is often determined by weighing the delivered products. The producer should be allowed to monitor the weighing and quality assessment, where feasible. It is sometimes agreed that, shortly after delivery, the contractor will provide the producer with a document stating its final evaluation of the goods' quality, based on the relevant criteria (such as the percentage of defective goods, moisture, or sugar or acid content). Weighing receipts are sometimes also provided. Losses due to spoilage may be accepted up to a certain percentage. The outcome of verification procedures at delivery is extremely important for the producer because it affects the price that will be paid.

137. The establishment of quality and quantity during inspection can often cause substantial logistical problems. Large contractors may be buying from hundreds or thousands of producers at one time. Various agents who are required to maintain consistent standards may conduct inspections. Fair and accurate decisions need to be made quickly. There is often little time for negotiations over quality. Because it is generally the contractor's obligation to inspect, it is normally the contractor that ensures that the inspection is done properly and in a timely fashion, including in situations where a buyer of the contractor is receiving the goods directly from the producer. As goods can be perishable, the timeliness of inspection and acceptance, if not an express term, would be implicit in the contract. Inspection costs are usually borne by the contractor.

138. It is usually advisable to provide for either both the producer and the contractor, or a trusted third party, to monitor the inspection. Possible fraud (such as manipulating produce weight) is a recurrent concern. The likelihood of fraud is reduced when both parties participate in the inspection, an independent third party participates, or the parties provide for a certification procedure or arbitration. The producer should be able to verify the process by which the determination is made. For example, it is common to include contractual terms providing that when the crop or livestock is to be weighed or examined, the producer should be able to view the weighing or examination and that such weighing should use certified scales. Normally when a third party conducts the inspection, the third party's determination binds both the producer and contractor.

139. The inspection may take place at producer's premises, at the contractor's premises, or some other place. Often there is a default rule specifying the place of inspection, and therefore the parties need to specify in the contract if they intend to specify an alternative place of

inspection. The method of inspection varies depending on the goods, but the purpose of examining the goods is generally the same; that is, to establish whether the goods meet the quantity and quality specifications. There are some contractual terms in the agreement that the parties may want to have flexibility in determining or modifying during the contract's performance, but normally the quality of the goods is not one of those terms.

140. There is a risk of abuse if the contractor is given unlimited discretion in examining and grading the delivered goods. Fair contractual provisions should not expose the producer to arbitrary decisions by the contractor. For instance, the contract may allow the producer to follow the process of fruit selection and classification, with the possibility of "express disagreement". Often, a better system is to provide for the presence of an independent expert or representative of a Government entity. The contractor also has to be aware of possible fraudulent behaviour by the producer (such as attempts to manipulate produce weight or to bribe the persons in charge of assessing the goods' quantity and quality). The contract may try to discourage these practices by providing severe remedies, such as damages and termination of the contract. However, these practices are mainly prevented by improving control procedures and by taking appropriate measures to ensure the integrity of the personnel in charge.

141. If the contractor can make a legitimate non-conformity claim, refusal to take delivery would not amount to a breach of contract under most legal systems. By contrast, the refusal of delivery of goods found by the contractor to be "non-conforming" goods is wrongful if inspection is carried out unfairly or fraudulently. The contractor would also not be entitled to refuse delivery of the goods if it has improperly evaluated their conformity (for instance by using the wrong parameters to assess the level of safety of an agricultural product, or resorting to an unskilled inspector).

142. A contractor that refuses to take delivery based on an unsubstantiated or fraudulent claim of goods non-conformity bears the consequences of the intentional breach. Depending on applicable law, these normally include liability for unforeseeable damages and, in the case of fundamental breach, termination, of the contract where the producer does not insist on specific performance of the contractor's obligation to take delivery (see Chapter 5 at paras. 142-143. Third parties

(*e.g.* certifiers) might have contributed to the fraud, being themselves liable for damages under contract or tort law.

143. An unintentional wrongful rejection may result from a mistake by a third party (*e.g.* certifier), if the third party is engaged by the contractor. When the certification contract is signed directly by the producer, as is often the case, it is more critical to decide who should bear the consequences of a certifier's mistake, especially if the certifier has been imposed or recommended by the contractor (see Chapter 5 at para. 144).

D. Price and payment

144. The contractor's main obligation is to pay the agreed price in return for the goods or services delivered by the producer. Provisions on the price for the products and services supplied by the producer are therefore among the most important terms in an agricultural production contract. The contract's sustainability depends largely on the parties' ability to agree on a fixed price, a price structure or a price calculation mechanism that adequately protects both parties from the commercial risks inherent to agricultural production in general and to the specific commodity in particular (see above, paras. 13-17). Ideally, the agreed price should afford both parties a rate of return that covers fixed and seasonal costs and be sufficiently profitable to make the contract attractive.

1. Price determination

145. Price is an essential term, and the failure to set the price or set a basis for determining the price may render the agreement unenforceable (see Chapter 2 at paras. 63-64).³⁴ However, even when a price term is normally required under domestic law, if there is a framework contract that provides for individual implementation agreements for each season or production cycles, or a long term agreement that provides for price negotiation during the contract's performance, an initial price term may not be necessary.

146. The producer should understand the price term and be able to assess the expected payment under the contract. When the contractor supplies the contract terms, the contractor may have an obligation to

³⁴ For international sales contracts, a similar rule is stated in Art. 14, CISG.

provide the producer complete and understandable information about the price.³⁵ This obligation may also be required under special legislation for agricultural production contracts. Regardless of the underlying legal requirements for price terms, a clear and transparent price clause, understood by both parties, may avoid future conflict and litigation. It is good practice to allow the producer or a third party to participate in the calculation or verify the price calculation method supplied by the contractor.³⁶

147. Unfair price terms may be sanctioned under both specific agricultural production legislation as well as general contract law.³⁷ Special provisions may apply to designated practices. For example, the contract may provide for the base compensation of one producer to be based on the performance of other producers (under so-called "tournament" compensation programmes). Tournaments can sometimes be prone to manipulation and favouritism because the contractor typically has the ability to affect some participants' performance by differentiated provision of inputs. These arrangements may seem justified because they provide incentives for the producer, but they are often perceived as a way to discriminate unfairly against individual producers, and these terms are prohibited under some agricultural production contract legislation.

148. Duress and gross disparity of bargaining power may be the basis to invalidate a price term.³⁸ Competition laws may also apply to correct market imbalances in agricultural production contracts and prevent abusive pricing. Voluntary codes of practice may also promote fair pricing (see Chapter 1 at para. 31).

2. Price mechanisms

149. Agricultural product prices in an agricultural production contract may be set by Government regulations that provide either minimum or

35 For international commercial contracts, a similar rule can be inferred from Art. 5.1.3, UPICC.

36 For international commercial contracts, a similar rule can be inferred from Art. 5.1.3, UPICC.

37 For international commercial contracts, a similar rule is stated in Art. 3.2.7(1), UPICC.

38 For international commercial contracts, a similar rule is stated in arts. 3.2.6 & 3.2.7, UPICC.

maximum prices or refer to prices set by markets. Absent Government regulations, the parties agree upon the prices. The price term may provide a fixed amount, a variable amount, or a combination of both. Fixed prices are generally set to reflect production costs and the producer's performance, and they often take into account, according to scales, variations in the delivered product's quantity, quality and classification. Scales may work as incentives for the producer, but they may also involve a penalty. Incentives may also take into account the application of certain diligence standards in the production process for quality and safety, and social and environmental objectives.

(a) Fixed prices

150. An agricultural production contract typically provides a price determined at the time the contract is entered into for a set amount of crops or livestock. This generally reflects the production costs and reasonable profit. It is common for contractors to use a market price at the time of delivery for the price term and, if so, it is essential that the exact market be specified in the contract.

151. A fixed price does not need to be expressed as a figure of a specific monetary unit in the contract. The agreement may provide that the price paid by the contractor may vary based on such factors as local or world market prices, the contractor's processing costs, the contractor's revenues from the processed product's sale, and the exchange rates between export and import countries. Nevertheless, generally when fixed prices are set without these qualifiers, market price variations between the time when the price is agreed and the price is actually due would not affect the amount to be paid to the producer. This could provide welcome certainty for the producer about the expected income when market prices fall down. However, if market prices rise, the producer loses the opportunity to receive the higher value. One potential solution for this problem could be dividing the produce into separate parts, where one part is at a fixed price and the other is left to market pricing, capturing in part the benefits of market prices.

152. The main advantage of using a market price is that it provides the flexibility to have a price set at the time of the agreement that reflects the price the parties would probably have negotiated at the time of delivery. A by-product of using market price is the lower incentive to side-sell by the producer, who cannot obtain a meaningfully higher price on the open market. The weakness arises from price volatility, leaving the profit of both the producer and contractor to rely on market price fluctuations.

(b) Price scales

153. For some commodities, the price varies based upon different performance measurements. The price may also vary over the contract's life based on key performance indicators. For contracts with a set price plus a premium or minus a penalty, it is common to adjust the final price by taking into account a pricing scale based on variations in the quantity and quality, and in some cases, efficiency. Price scales and other price adjustments may be designed as either incentives or penalties for the producer. Incentives may also take into account the application of certain diligence standards in the production process, product quality, and safety, social and environmental objectives. Because the producer must rely on the contractor to evaluate these factors, the contractor has an obligation to meet objective industry standards.³⁹ Functionally, such adjustments may be used to supplement or displace available contract remedies when the producer fails to achieve the required quality or quantity.

154. When the price term is based on payment for the producer's services, the payment rate is usually a set base price with adjustments for various performance factors. In a livestock contract, for example, this may include feed conversion, death loss and fuel usage payments. Although the contractor may have supplied the food and animals, the price will not be based on the input costs, but on livestock weight upon delivery to the contractor. The price may be linked to flexible parameters generally based on the revenues obtained by the contractor from the product or after the product is delivered by the producer. These parameters typically depend on local or world market prices, the contractor's processing costs, contractor's revenues from the processed product's sale, and the exchange rates among export and import countries. The timing when these factors are measured, how these factors come into play with respect to price volatility and incurred risks, and the share to which the producer is entitled are essential terms in the contract.

155. Prices can combine a fixed amount and a flexible share based on one or many factors. When entering into a contract, contractors and especially producers are well advised to consider the potential advantages and risks of the chosen pricing mechanism. One advantage of

³⁹ For international commercial contracts, a similar rule can be inferred from Art. 5.1.4, UPICC.

price scales is the incentive created for the producer to create high quality goods, which may lead to a win-win situation and generate higher profits for both parties. The associated risks stem from the complexity of scales, which may lead to both confusion and manipulation, when opportunistic parties try to abuse the system (*e.g.* by the contractor downgrading products to purchase them cheaper or the producer bundling lower quality products with higher quality ones to sell them for a higher price).

156. It is also good practice to provide mechanisms for monitoring the contractor's application of the price formula (which includes for example product classification and sorting), either by allowing the producer to participate or verify the price applied by the contractor, or through the intervention of a third party.

157. Price terms should be transparent and clear. Poorly drafted price terms contribute to disputes, litigation, delays and costs. They may also lead to contract breaches and cause producers to misrepresent or misunderstand inadvertently how the price is to be calculated. Price terms that are less transparent may allow manipulations by contractors to reduce payment. Whatever the pricing mechanism, it should be understood by all parties at the time of the agreement.

158. Over a period of time, changing market conditions, among other major changes affecting the contractual relationship, can alter the assumptions that the parties had when they concluded the contract. For this reason, the parties may consider including a predetermined revision mechanism in the contract such as a price adjustment clause to allow for price adjustment because of changed market conditions⁴⁰ (see Chapter 4 at para. 18).

3. Time and method of payment

159. The contract should specify the time and method of payment (for both goods and inputs). Late payment or payment through a different method may negatively affect the producer's ability to meet its necessary expenses and furthermore may have implications for producer's obligations under separate financing agreements for facilities, operating expenses, etc. These terms are normally set out expressly in the contract.

⁴⁰ For international commercial contracts, see Art. 6.2.2, UPICC.

The parties' past practices and trade usage may supplement the express agreement.⁴¹ Although time and method of payment can be supplied by default terms, express provisions on who, when and how payment is to be made promote certainty and reduce the possibility of disputes. Payment might be prior to delivery, upon delivery, or a certain number of days after delivery. If the price is based on a market price, it is important to specify how and when the market price is to be determined. It is also important to consider, when relevant, the producer's obligation to pay back any advances provided by the contractor (see above at paras. 87-91).

160. Payment terms vary widely depending on both the contract type and the parties' private arrangements. For example, some contracts provide for immediate on-the-spot cash payments, while others provide for staggered payments based on further deliveries, inspections and processing. As payment often takes place after delivery, the producer is exposed to the risk of not being paid, for instance if the contractor becomes insolvent. This potential problem is exacerbated if title to the goods has already passed to the contractor under the contract or otherwise. This risk is mitigated by law in some jurisdictions, which provide the producer with a lien against the goods. In some other jurisdictions, the law provides for guarantee funds through public financial institutions, insurance schemes or payment guarantees to protect producers against contractor insolvency. These are mandatory obligations on the contractor that cannot be waived in the contract.

161. Delayed payment may expose the producer to additional risks. For example, delayed payment may make it difficult for the producer to obtain additional financing or expose the producer to cost increases due to inflation, which may be significant. This risk is mitigated in some jurisdictions by statutory payment deadlines that subject the contractor to an automatic claim of interest for late payment at a more favourable rate than the official rate at which the producer is entitled to recover. Absent specific interest rates for agricultural production contracts, most domestic and some international law provide interest rates.⁴²

162. The payment term is often connected to the parties' other obligations (such as inspection, packaging and shipment). Thus, payment

41 For international sales contracts, a similar rule is stated in Art. 9(1), CISG.

42 For international commercial contracts, a similar rule is stated in Art. 7.4.9, UPICC.

may depend upon conditions that have to be met before payment will be made. For instance, before being paid, the producer may be required to request payment, provide an invoice, provide certain certifications, or wait until after inspection, cleaning, or other quality verification, including potential laboratory testing. Such conditions, however, cannot be commercially unreasonable.

163. When the goods are bought for export, the contract may require payment to be made in a different currency than the currency in which the price is set. If not provided for in the agreement, the applicable default rules determine the exchange rate and the time when the exchange rate is determined.⁴³ Some domestic legislation requires that contracts use the local currency. The choice of currency may represent an important aspect of the economic transaction because currencies differ in terms of value on the exchange market and in terms of stability. The choice of currency, if set in the contract, may then contribute to the allocation of risks between the parties.⁴⁴ This explains why the use of a currency that is different from the one set in the contract (or in the law) may be considered a form of breach, unless it is excused under the applicable law.⁴⁵

III. Additional obligations

164. The parties sometimes agree on additional obligations beyond the core obligations of production, delivery, and price payment when negotiating agricultural production contracts. The following sections, however, are not meant to be exhaustive and other obligations may need to be considered.

A. *Insurance obligations*

165. Though many agricultural production contracts do not contain any provisions on insurance, due to a lack of availability or affordability, some contracts may provide insurance obligations. In such cases, the contract should in the first place specify which party has the obligation to

⁴³ For international commercial contracts, a similar rule is stated in Art. 6.1.9, UPICC.

⁴⁴ For international commercial contracts, a similar rule can be inferred from Art. 6.1.9(1)(b), UPICC.

⁴⁵ For international commercial contracts, a similar rule can be inferred from Art. 6.1.9(2), UPICC.

obtain insurance, and indicate which type of insurance should be purchased (such as that for the facilities, crops and livestock, liability insurance for all injuries or property damage to third parties which may occur on the premises, or casualty, health and life insurance for the main parties to the contract).

166. Insurance contracts are complex legal instruments. The contract should describe in sufficient detail the coverage's minimal features. Merely obliging a party to take insurance, with no further clarification (such as simply requiring the purchase of "adequate insurance"), may not guarantee the necessary coverage. Insurance clauses should at least state the main minimum coverage requirements, such as the risks to be insured (*e.g.* fire, theft, disease or hail) and the amounts to be covered. For liability insurance, the contract should specify the minimum limits of guarantee and, for life insurance, the amount to be covered. Special care should be taken to verify that the insurance clause conforms to the requirements of the law. Insurance law is often governed by mandatory principles and rules.

167. Transfer of the insurance benefit to the contractor upon delivery can also be effected by an appropriate clause, provided the insurance policy or the applicable law contains a corresponding provision. If appropriate, a loss payee designation clause could also be stipulated in favour of a third party (such as a financing institution).

168. Some more affordable forms of insurance may be accessible through cooperative or mutual entities (see above, Chapter 2 at para. 53). Micro-insurance is developing in many parts of the world to offer more accessible forms of coverage for agricultural risks. Weather derivatives, when available, can also offer relatively affordable forms of protection, due to their simplicity in implementation. The risk occurs when a factor (such as draught or rain) goes over or under a certain level and, when this happens, the insured party receives a pre-determined amount.

B. Record keeping and information management

169. Certain administrative obligations are often imposed on the producer. For example, the producer may be required to keep a special bank account to receive payments made by the contractor under the contract. A contract for the supply of dairy animals may provide that all animals must be identified in appropriate records. The contractor may require communication of various information concerning the produce. In some contracts, information from the producer may be required

through periodic reporting, possibly based on the contractor's obligations towards third parties (public agencies, inspection authorities, clients, financiers, etc.). Such reporting may be due upon delivery, or on a more frequent basis. More general management obligations are imposed by some contracts, requiring the producer to keep appropriate records (in order to justify compliance with different obligations) and to follow the professional advice provided by the contractor for managing its business. The preparation of a business plan may be required, especially when financing is to be obtained.

170. Many contracts provide that the producer will have to attend training sessions organised by the contractor and to provide the contractor with information on supervening events that affect the produce. For example, a producer may incur liability for damages if it fails to inform the contractor of an infestation that reduces output quality or quantity and this causes a change in the contractor's purchase plan, loss of trade opportunities, or an inability to take precautions or corrective measures.

171. Some contracts expressly deal with the treatment of confidential information exchanged between the parties. Regardless of possible contractual remedies (*e.g.* damages or contract termination), disclosure of confidential information may represent a major threat to the trust between the parties, possibly leading to its final breakdown. However, clauses providing to keep the entire contract confidential are not always valid. In certain jurisdictions, clauses that prohibit the producer from disclosing terms, conditions and prices contained in the contract are void. The purpose is to permit discussion of production contract terms with third parties (such as family members, legal advisors, landowners, financial institutions or Government agencies), in order to enhance informed consent and favour competition (see also Chapter 2 at paras. 84-90).

C. Community interests

172. When the producer leases land from the State, the producer will have to comply with any applicable legal obligations regarding the protection of community interests. This obligation may extend to the contractor as well, if the law so requires or the contractor subscribes to codes of conducts, practices, or guidelines that impose this obligation. To the extent that these obligations concern the production process (*e.g.* use of pesticides, use of environmentally friendly production techniques,

etc.) they may be actionable in cases where the contractor does not adequately monitor the producer's behaviour.

IV. Transfer of obligations

173. Generally, a contracting party can later assign its rights under the contract, but cannot transfer its obligations⁴⁶ without the consent of the other party.⁴⁷ For the contractor, the rights under the contract are usually the rights to the production from the producer (the obligor). It is possible for the contractor (the assignor) to assign these rights to a third party (the assignee), merely through agreement with the third party because this right is not considered personal in nature.⁴⁸ The contractor will have to ensure that there is no contractual provision that prevents it from assigning its right to the production, or any other right, to a third party.⁴⁹ Because the contracts are usually drafted by and for the contractor, this clause is not likely to appear. Whether the contractor can transfer any of its duties (such as the supply of inputs, technical services, or transportation), is normally expressly provided for in the contract. Absent an express term, the contractor can usually only transfer its duties with the producer's consent.⁵⁰

46 For international commercial contracts, see arts. 9.1.1 & 9.2.1, UPICC.

47 For international commercial contracts, a similar rule is stated in Art. 9.2.3, UPICC.

48 For international commercial contracts, see Art. 9.1.7, UPICC.

49 For international commercial contracts, see Art. 9.1.9, UPICC.

50 For international commercial contracts, a similar rule is stated in Art. 9.2.3, UPICC.

CHAPTER 4 – EXCUSES FOR NON-PERFORMANCE

1. After entering into an agricultural production contract, performance may be affected by certain supervening events. Some supervening events draw particular attention because they may provide legal excuses for non-performance or may trigger other legal consequences. While this may happen for all types of contracts, certain occurrences can be expected to play a greater role in agricultural production. Section I of this Chapter introduces the basic underlying legal issues raised by such occurrences. Section II outlines how different supervening events may be characterised by contracts and the applicable law. Lastly, Section III explores the consequences of legal recognition of supervening events, so that parties may better envisage and address these events when entering into a contractual relationship.

I. Force majeure and change of circumstances in agricultural production contracts

A. Supervening events affecting the performance of the parties

2. Agricultural production contracts are particularly vulnerable to specific external factors affecting the producer's ability to perform its obligations. Natural events such as floods or droughts, abrupt climatic changes or exceptionally high or low temperatures are among the most common events that could destroy, in whole or in part, a producer's goods. In this regard, climate change and the increased weather unpredictability might give rise to supervening events more often than before. Natural events may also include insects or other plagues that may affect crops or epidemics that may attack livestock.

3. Other possible supervening factors, while not as typical in agricultural production, may nevertheless influence the ability of either party to perform the contract. This is the case for occurrences such as changes in legislation or governmental policy concerning agriculture or having a more general application, which could be determined either at the domestic or international level; upheavals ranging from riots to revolutions or armed conflicts; and social events such as strikes affecting

either the production process or the availability of transport and other facilities. Other examples include: a government's decision to ban the export of specified agricultural products may impede the full performance of obligations under an existing contract; changes in health or environmental regulations may reduce the value of a specific production; embargoes against a particular country may constitute a major obstacle to performance; a strike in the communication or transportation industries may also affect the ability of parties to perform; and abrupt depreciation of currency or a freezing of fund transfers may also influence the fulfilment of the obligation to pay the price. Further disruptive factors that may heavily modify the original contractual equilibrium may happen as a result of fluctuations in market conditions affecting prices or supply.

4. Furthermore, the possibility of these supervening events is increased by the duration of an agricultural production contract, which usually ranges from medium to long term (see Chapter 6 at paras. 4-10) and by the fact that parties typically undertake to make periodic or deferred performances (see Chapter 3 at para. 3). In addition, the agricultural production contract defined in the scope of the Guide generally entails a certain level of interdependency of performances by the producer and the contractor, with the latter providing, typically, the supply of inputs (*e.g.* goods, services or financing) needed by the former to fulfil its obligations. In the case of a *force majeure* event preventing product delivery, the contractor may have already performed its obligations relating to the inputs. Thus, the contractor would already have lost the value of such performance in addition to not receiving the expected end product. To summarise, events affecting either party's ability to perform would most often necessarily affect the other party's own performance under the contract.

B. Force majeure versus change of circumstances

5. While the supervening events described above may in one way or another have an impact on the parties' performance of their obligations, it will depend on the applicable law whether, and to what extent, those events would be considered relevant from a legal standpoint and what consequences they would entail for the parties' obligations and their contract as a whole.

6. Generally, domestic laws only provide for exceptional relief in the occurrence of events, arising after conclusion of a contract, that are

unpredictable, inevitable and beyond the parties' reasonable control, and that objectively prevent one or both of them from performing. One may, for example, think of an exceptional flood destroying all of the growing crops being raised under a contract on a specified plot of land. The typical effect of such an event, when recognised, is an exemption from performance. As will be seen below, however, variations in this situation exist under different domestic laws.

7. Though each legal system may employ its own terminology, *force majeure* has become a term of art not only in international contracts, especially when a specific clause is drafted to cover these situations, but also in uniform law instruments, literature and judicial or arbitral decisions.¹ It is commonly used in agricultural production contracts as well, and the term is used in this Chapter to refer both to express contractual provisions and to the default regime applicable in the absence of such provisions.

8. Even if no supervening event makes performance impossible, changing circumstances over the life of the contract may go beyond the risks contemplated at the time of entering into the contract. Changes in circumstances may not necessarily impede performance, but where they fundamentally alter the balance of the relationship, they constitute a frequent ground for non-performance. A number of legal systems have neither adopted specific provisions nor developed *ad hoc* judicial solutions for such situations, at least for general contract law. Moreover, even where a rule does exist, its effects may differ greatly, ranging from an exemption from performance resulting from the same legal regime as *force majeure* events, giving one or both parties a right to termination, restoring the contractual equilibrium by imposing a duty or granting a right to renegotiate the terms of the agreement or, more rarely, to recognising a right to adapt the contract to the changed circumstances.

9. Again, various expressions and concepts are used in domestic law. *Hardship* is a common term found in international contracts and literature to describe exceptional changes of circumstances that may give rise to a contractual or judicial remedy, or clauses regulating such situations.² It does not seem, however, to be widely employed in the context of contract farming. As a result, the more neutral expression

¹ See, for example, use of the term in Art. 7.1.7, UPICC.

² See, for example, use of the term in Arts. 6.2.1 and 6.2.2, UPICC.

“change of circumstances” is used in the Guide. This term should, however, be understood as a shorthand to refer to situations akin to “hardship”, that is exceptional changes of circumstances that may be considered relevant by parties or by the rules in a legal system.

10. In this Chapter, both scenarios are considered. Parties should, however, be aware that the divide between *force majeure* and “change of circumstances” might be a matter of interpretation of the factual circumstances of the case or the applicable law. Contractual provisions may bridge this divide by providing for analogous remedies (e.g. a periodical or occasional revision of contractual terms).

C. Contractual allocation of risks through *force majeure* clauses

11. The parties to a production contract are generally free to agree on a specific provision on *force majeure*, however worded, rather than rely upon the general principles provided by the governing law. Such clauses are common in international commercial practice and may serve multiple purposes, either restricting or enlarging the applicable law’s default rules that qualify supervening events and their characteristics and may modify their effects, or providing for specific issues the parties did not expressly consider. In agricultural production, as will be seen in more detail below, some contracts do contain at least a minimum reference to *force majeure* situations, and it is not uncommon to have one or more clauses tailored to the specificities of these transactions. However, this issue seems to draw less attention than could be expected given the possibly crucial role of supervening events, and there is little evidence of heavily negotiated and complex texts such as those that may be found in other industry sectors.

12. Parties must be aware that inserting a risk allocation or *force majeure* clause into their contract does not necessarily make the applicable law irrelevant. First, general clauses referring to *force majeure* without further specifications will be interpreted in accordance with the applicable law. This may lead to different results depending on jurisdiction. Second, contractual lists of relevant supervening events may be construed in different ways depending on the adjudicating body and the jurisdiction. They may be qualified as non-exclusive, thereby giving a possible gap-filling role to the applicable law. The parties can make clear that the list is not exhaustive: by using expressions like “such as”, “highlighting, among other”, “including, but not limited to”; by simply inserting suspension points or “etc.”; or by adding a cover-all final

description. On the other hand, detailed lists, even when followed by a general cover-all clause, may be restrictively interpreted only to cover events of a type similar to those specified in the clause, thus excluding other occurrences which may give rise to an excuse under the applicable law. In other instances, the list may be exhaustive (*e.g.* when it only refers to natural calamities, when specific events are expressly excluded from an otherwise exemplary list, or when different consequences are attached to the occurrence of different events). Parties wishing to include such lists in their contract are advised to expressly clarify those points.

13. It may also be difficult to distinguish express *force majeure* clauses drafted specifically in favour of one party from a contractual exclusion or limitation of liability. In theory, the difference is clear, because by definition *force majeure* provisions address exceptional events falling outside of the parties' control, while exclusion or limitation of liability clauses generally apply to non-performance. Parties may, however, decide to modify the typical characteristics of the event triggering an excuse and to exonerate the non-performing party even when the impediment was avoidable or foreseeable. The line between an extended *force majeure* clause and an exclusion from liability may then become blurred. Parties should thus be aware that an unexpected exclusion or limitation of liability might be hidden in loosely drafted *force majeure* provisions. On the other hand, many legal systems impose restrictions on exclusions of liability (*e.g.* striking them down if they extend to wilful or grossly negligent behaviour of the obligor or limiting the possibility to insert them in standard contracts).

14. Finally, specific legislation may sometimes impose other mandatory rules from which parties may not derogate in their contracts. While legislation of this kind referring to *force majeure* events are rather rare, they may be relevant when applied in the agricultural production context. Such legislation may impose certain minimum content for the contract, including a *force majeure* provision or other risk allocation mechanisms designed for this type of situation.

D. Risk allocation and title transfer

15. When the obligation to deliver is affected by a *force majeure* event, risk allocation may depend on whether the contract provides for delivery and transfer of title to goods, as happens in sales contracts. Under many domestic law systems, the risk of fortuitous loss of identified goods is borne by their owner. As a result, if title has already passed to

the buyer, the crop has already been sold under contract irrespective of delivery, and the seller – while being excused from performing – is still entitled to the price. Because this is more properly framed as a passage of risk question for the perishing of goods to be transferred from one party to the other, it is addressed further in the Chapter on Obligations of the Parties (see Chapter 3 at paras. 7-12).

E. Insurance and other risk mitigation and allocation schemes

16. Anticipating the risks involved in production is essential to the economic viability of any agricultural undertaking. Parties, and in particular producers, may respond to this need by contracting insurance against the occurrence of adverse events, insofar as sufficient coverage for such events is available. In this regard, it should be noted that insurers have started to develop defensive measures, by excluding some extreme adverse climatic events, to protect their business models against highly unpredictable weather patterns, which are becoming more frequent with global climate change. On the other hand, insurers have also launched new products, such as weather derivatives, allowing for more innovative risk management. Contracts occasionally contain an express requirement that insurance be obtained, either in general terms or against specific risks (see Chapter 3, at paras. 165-168).

17. Domestic legislation may provide compulsory agricultural insurance of certain types, such as crop insurance in the case of *force majeure*. Affordability may be enhanced by cooperatives or mutual entities and by the availability of micro-insurance, as well as by the existence of specific domestic insurance schemes (see Chapter 2, at para. 53).

18. Parties may also adopt simpler risk mitigation mechanisms by inserting a periodic adaptation or revision clause into their contract. For example, a price revision clause may be used to limit the risk of currency exchange fluctuations. These clauses often provide for an automatic price adjustment according to a pre-established schedule which is triggered by a depreciation or appreciation of the currency in which the price is denominated above an agreed threshold, usually expressed as a percentage of the unit price. Other price adjustment mechanisms may be used to limit the risks associated with market fluctuations. In evaluating the overall balance and fairness of contractual terms, with particular regard to *force majeure* provisions, the impact of the availability of such risk mitigation mechanisms should not be underestimated.

II. Events qualifying as force majeure and change of circumstances

A. *General notion of force majeure in contractual practice*

19. Agricultural production contracts may contain a general reference to “*force majeure*” as the outer limit of the parties’ liability, sometimes coupled with another term such as “fortuitous case.” When no further specification is provided, the clause will be interpreted in light of the applicable domestic law. In those jurisdictions where the notion of *force majeure* is part of the general law of obligations and contract, parties can be expected to rely on its usual interpretation by domestic courts and will feel less compelled to specify its exact scope and implications, unless they intend to deviate from this general understanding. When, on the other hand, the governing law does not recognise the notion of *force majeure*, its contours will be shaped by the contract as a whole and by domestic and international contractual practice in applying analogous clauses. In this situation, a more detailed contractual provision is thus more common and may be more advisable. As seen above, an inclusion of a list of examples, exhaustive or not, is a widely used method for clarifying the parties’ intentions.

20. Some contracts may also use the terms “adverse factors” or “adverse events,” with or without additional language, such as “alien to the will of the parties” or “beyond the control of the parties.” In some cases, this language may be used without specifying whether it includes only impediments or also mere difficulties. Furthermore, contracts usually do not stipulate the effects on the parties’ performance or, if they do, they envisage as a consequence of an event’s occurrence that renegotiation should ensue. It is therefore more akin to a clause on change of circumstances.

21. A *force majeure* event is generally considered an unforeseeable and unavoidable event outside the parties’ control. All three requirements are sometimes expressly mentioned in the contract, but in other instances, only one or two of them will be highlighted. Long and complex *force majeure* clauses, however, may raise the issue whether the parties purposely intended to exclude any omitted requirement(s) or not. The contract will then have to be interpreted in light of the applicable law. When a *force majeure* clause contains a list of events that serves as an exemplification of the kinds of circumstances covered by the clause, this list will be instrumental as well in interpreting the meaning of the more general requirements.

22. General *force majeure* clauses are usually applicable to both parties' performance, unless they are expressly designed to apply to one party only. Another important element to be considered is the extent to which the *force majeure* event should affect the parties' performance before the clause comes into play. Sometimes contracts expressly require that the obligation become impossible to perform. There are other expressions with the same meaning (e.g. "preventing any of the parties from the exact execution of their duties," or "events that disable the fulfilment of this agreement"). Contracts may further address whether the impediment is permanent or temporary in nature, a distinction which also shapes the consequences of the impediment's occurrence and is addressed below in Part III.

23. The uncontrollable or inevitable nature of the event is sometimes mitigated when the parties refer to a reasonability test. The contract may also include specifications regarding the causal link between the event and the failure to perform, indicating for example that both the direct and indirect effects of a *force majeure* event on the performance of the parties' obligations will be relevant, or that only direct effects are to be considered (e.g. including all occurrences of an unexpected and unavoidable nature that may directly prevent any of the parties from exact execution of their duties).

24. When the contract does not contain a provision regulating the extent of the parties' liability, the question will be left to the applicable law. In this respect, a comparative analysis of existing legal systems shows that though different models have been adopted, they all share a few common denominators. First, a determining factor is often whether, in practice, the supervening event is considered to be within the party's "typical sphere of risk" (e.g. connected to its performance in the context of the contractual agreement). Second, courts generally tend to interpret the notion of exempting events narrowly and thus, in the absence of a specific contractual clause, recognition of such events is a rare occurrence in the context of commercial contracts.

1. *Natural events ("Acts of God")*

25. The paramount example of an event that may affect the producer's performance is a natural catastrophe destroying the crops to be produced and delivered, or killing the flock of animals to be raised, in whole or in part. Contracts with a *force majeure* clause containing a list of examples almost invariably include natural events such as floods, frosts, droughts,

storms, fires and earthquakes. In this case, the listed events should satisfy the conditions set forth within the general clause. Conversely, other contracts may expressly state that natural factors fall in the range of the risks borne by the producer. This clause should be read together with any risk mitigation mechanism put in place either by the contract itself (*e.g.* compensation for selected types of natural disasters (see below at para. 45) or by the producer (*e.g.* through insurance coverage).

26. When the contract is silent or only contains a general reference to *force majeure*, the relevance of certain natural events destroying the producer's production will have to be assessed under the applicable domestic law. It may be difficult for the producer to prove that the event was outside the normal sphere of control of its activity, at least when the destruction of part of the crops sold under contract was due to bad (or even exceptionally bad) weather conditions.

27. Epidemics and pests are particularly important because most contracts require the producer to take precautions to guard crops against them and more specifically to comply with the contractor's instructions. It would be difficult for a producer to prove that such occurrences are outside its sphere of risk. Moreover, they are not generally mentioned in the lists of events contained in *force majeure* clauses. Some contracts even provide that the contractor has the right to refuse to harvest crops attacked by flies or mites, or to discard the harvested crop without any compensation to the producer. Accordingly, it is crucial for producers to be aware of their contractual obligations and exposure to the risk associated with pests.

2. Governmental acts

28. The actions of a legislature or other government body exercising its sovereign powers can be another typical source of disruption of the parties' performance. A public authority exercising sovereign powers, including the implementation of international resolutions or decisions, is to be distinguished from a governmental body participating as a private actor in the market. While natural catastrophes most commonly – although not exclusively – affect the producer's ability to perform, governmental acts can also impede either or both parties from fulfilling their obligations. Contractual clauses may refer generally to "acts of governmental authorities" or more specifically to "any act or omission of any national or local authority".

3. *Other disturbances: strikes, wars, social unrest, and market disruptions*

29. Among the non-natural events affecting the parties' performance, strikes or other labour union actions or resolutions are often expressly mentioned, sometimes including illegal or non-authorized actions. Mob, riots, and other social disturbances are additional events that often appear in *force majeure* clauses, as well as wars, insurrections and revolutions. Generally speaking, an employee strike affecting either party would rarely qualify as an event justifying failure or delay in performing, because it would not be considered outside of the employer's sphere of risk unless the contract specifies otherwise. Interruption of services such as transportation or communication, on the other hand, would fall more easily under a general *force majeure* clause or be recognised by domestic laws as excusing or suspending the obligation to perform. Some contracts, however, expressly exclude strikes, or impose an obligation on the producer to ensure that the products reach the contractor even in the case of a transportation strike (at the contractor's cost), even if the contract provides that it is the contractor's obligation to take delivery at the producer's premises.

30. However, several types of events are typically not viewed as relevant. Thus, market disruptions are not generally considered to be *force majeure* or adverse events in the agricultural production context, nor are they specifically listed in *force majeure* clauses. Parties may nonetheless take into account possible future changes in the market by introducing into their contract a price adjustment or index clause or other price calculation mechanisms based on external elements (see Chapter 3 at paras. 150-158).

31. Finally, there may be situations where one of the parties (and in particular, the producer) cannot perform because of some personal impediment. Generally, a party's subjective inability to perform due to an illness, for example, does not lead to an excuse or a suspension of the party's obligations, unless the performance is considered personal in nature. In these situations, it may be possible for the producer to obtain insurance covering such risks.

B. Relevant change of circumstances in contractual practice

32. Generally speaking, specific "hardship-like" clauses are not typically part of an agricultural production contract. These clauses are

different from *force majeure* provisions as they refer to a change of circumstances that would not prevent performance but merely render it more onerous for one of the parties. However, as mentioned earlier, contracts often contain price adjustment clauses that may refer to changes in the relative value of certain currencies, inflation, or other parameters in order to mitigate the effect of supervening factors. In addition, the terms “adverse factors” or “adverse events” are sometimes used without specifying whether they only include impediments or also mere difficulties to perform.

33. If the contract does not contain a provision on changed circumstances, the traditional response in a number of legal systems would be to deny any remedy unless the situation gave rise to an impossibility to perform. However, recently many jurisdictions have developed legislative or judicial nuances to this rule. Broadly speaking, the event that triggers application of the rules on change of circumstances in those systems should be exceptional, unforeseeable, unavoidable and beyond the parties’ control.³ The difficulty created by such events should cause an excessive burden or windfall for one of the parties. The effects of the recognition of a relevant change of circumstances may vary greatly among jurisdictions and such effects are considered below in Part III.

C. Burden of proof

34. Issues of evidence are often overlooked by contracting parties, but they may well determine the outcome of a dispute in a number of cases. Generally, the party whose performance is allegedly affected by the *force majeure* event (or by the change of circumstances) bears the burden of proving the occurrence of the event, its required characteristics under the contract or applicable law, and the causal link between the event and the non-performance. The contractual clause can, however, be drafted in a way that places this burden of proof upon the other party.

35. Contracts may include more complex procedures such as the filing of a formal report to be reviewed and accepted by the other party (often the contractor when the event is a natural catastrophe affecting the production), or a decision by a local authority if the parties cannot agree on the evidence.

³ For international commercial contracts, a similar rule is stated in Art. 6.2.2, UPICC.

36. Proving the causal link between the inability to perform and an external unavoidable event may in practice be difficult. The type of reliable, compelling evidence required for demonstrating such a link (such as having government officials visit the fields and document the situation, taking pictures and detailed notes of the extent of the losses or damages caused by *force majeure*, collecting newspaper articles, etc.) may only become apparent after a conflict has arisen. The party invoking *force majeure* should bear this difficulty in mind and is well advised to obtain such evidence while still physically possible. Indeed, the exceptional or uncontrollable character of a natural event could be subject to dispute. For storms or other exceptional climatic events, the contract may require a certification by a meteorological station. Certifications provided by competent market authorities or other comparable institutions are also referred to as proof that an exceptional market disruption has occurred. Similarly, when dealing with pests, a certification on the existence and severity of the infestation could be procured from a competent governmental authority.

37. The question of evidence is linked to the requirement to give notice to the other party when a relevant supervening circumstance occurs. The notice requirement may constitute an additional obligation of the affected party and will be addressed below at paras. 46-51.

III. Consequences of the recognition of force majeure and change of circumstances

A. Effects on the parties' obligations

1. Excuse from non-performance

38. The recognition of a *force majeure* event in most jurisdictions traditionally exonerates the party from performing the obligation affected by the event. This consequence is based on the assumption that it would be unfair to hold a party liable for a performance that has become impossible or, if allowed by the governing law, more onerous. In those situations, the applicable law may consider that the contract is deprived of its foundations, thus exonerating both parties, or may merely preclude

the non-affected party from raising a claim for damages.⁴ This is reflected in several contracts containing a *force majeure* clause, where it is expressly stated or implied that the affected party is excused from performing, or that no damages or agreed penalties for delay in performance are due.

39. Whether the producer would still be liable for payment of the inputs received or for restitution of any loans to the contractor if the producer's obligation to deliver is excused or suspended is an important question that may arise in the context of contract farming. Several contracts contain an express provision in this regard, specifying that the producer should still perform such obligations. The provision may be worded in more general terms referring to "all pending liquidations and other accounts" or "all outstanding payments" which should be settled independently of the occurrence of a *force majeure* event.

40. On the other hand, neither the contract nor the applicable law generally envisage excuse from non-performance as a typical consequence of the occurrence of an event that is qualified as a change of circumstances.⁵

2. *Suspension of performance*

41. The classical theory of excuse was developed with regard to simple contracts where performance is instantaneous and its supervening impossibility puts an end to any future meaningful conduct by the affected party. There is a recent tendency, however, to prefer, at least initially, a less disruptive approach and to treat that obligation to perform as merely suspended for the impediment's duration.⁶ Suspension is also often expressly provided for in agricultural production contracts.

42. Suspension of performance may take different forms. In most known contracts, no impact on contractual duration is expressly specified. Occasionally, it automatically entails an extension of the contract's duration for a temporary period of time equal to the duration of the impediment. If parties choose suspension of performance as the

⁴ For international commercial contracts, a similar rule is stated in Art. 7.1.7(4), UPICC and, for international commercial sales in Art. 79(5), CISG.

⁵ For international commercial contracts, see Art. 6.2.3 UPICC, Comment 4.

⁶ For international commercial contracts, a similar rule is stated in Art. 7.1.7(2), UPICC and, for international commercial sales in Art. 79(3), CISG.

consequence of a *force majeure* event, they could clarify whether it gives rise to an automatic extension of the contract's duration, in order to avoid uncertainties in contractual interpretation.

43. Suspension of performance due to a *force majeure* event cannot be expected to have an indefinite duration. If suspension were to extend indefinitely, this would be considered termination. Considering performance excused after a specified period of time has elapsed is one possible solution. Giving a right to the other party to terminate the contract, again after a period of time, is another possible solution. Obliging the parties to renegotiate the terms of their agreement is a further possibility (for termination and renegotiation see below, paras. 52-58). It may be further advisable to indicate the time from which the period will start running: when the impediment arose, when the party became aware of it, or – if an obligation to provide notice exists – when notice was served on the other party.

44. When performance of the producer's obligation to deliver is merely suspended, a question may arise whether the other party may procure the missing quantity of product from other suppliers during the time of the suspension. The answer will depend on various factors, notably the existence of an exclusivity clause binding the contractor.

3. Compensation and indemnities

45. In an effort to achieve fair regulation, contracts may provide mechanisms to redistribute the risk of a *force majeure* event affecting only the producer, through partial compensation of loss by the other party. This may be limited to a specific type of event, like hailstorms, limited in time and applicable only to specific contractual agreements. It may also consist of a redistribution of insurance compensations received by the contractor. On the other hand, some clauses are reported to expressly exclude any compensation to the producer for losses due to a *force majeure* event.

4. Additional obligations: notice and mitigation requirements

46. Only a few legal systems require that the affected party give notice to the other party of the alleged *force majeure* event, whereas

international instruments⁷ and international contractual practice seem to favour this obligation. Several agricultural production contracts expressly provide for a notice requirement and parties are advised to insert one into their agreement should they wish to introduce a *force majeure* clause. A notice requirement would be beneficial also when parties wish to insert into their contract a clause regulating the effects of exceptional changes of circumstances.

47. Parties may wish to address expressly in their contract a number of specific issues relating to the obligation to give notice of the supervening event. The form that the notice should take – as some contracts require it to be, for example, in written form – is one such issue. In the absence of a contractual provision, the general rules of the governing law on contractual communications will apply. Furthermore, even when the substantive law validates informal communications, the law of evidence may, depending on the jurisdiction, impose additional requirements.

48. The time within which notice should be given is also relevant. Contractual practice ranges from the indication of a specific period or date to general clauses (such as “as soon as possible,” “immediately,” or the like). In this context, parties may wish to take into account the fact that the *force majeure* event (or the event giving rise to an exceptional change of circumstances) may render the notice – or its reaching the addressee – impossible or difficult, and provide for such an occurrence. The place where notice is to be served (*e.g.* when the other party has more than one establishment) or to whom (*e.g.* to certain employees or family members) are related elements which may be contractually regulated. Finally, parties may also provide for an obligation to give notice of the end of the impediment, when it is temporary and gives rise to a mere suspension of the party’s obligations.

49. The occurrence of a recognised *force majeure* event may give rise to further obligations of the parties or the affected party, deriving from the relational nature of the contract and the parties’ interest in keeping the relationship alive despite the adverse circumstances. Certain contracts, for example, expressly provide for duties to exercise all due

⁷ For international commercial contracts, a similar rule is stated in Art. 7.1.7(3), UPICC and, for international commercial sales in Art. 79(4), CISG.

diligence to minimise the extent of the prevention or delay in the general performance of the contract.⁸

50. Notice and mitigation requirements may be bundled together in a more complete contractual clause. This may require, for example, that after the occurrence of the relevant event, the affected party shall provide further notices to the other party, fully describing the event and its cause, providing or updating information relating to the efforts made to avoid or mitigate its effects, and estimating, to the extent practicable, the time the affected party reasonably expects to be unable to carry out its affected obligations. This kind of very detailed contractual provision, when applied to both parties, may reflect the general duty to cooperate, which arises out of the relational nature of the contract. A *force majeure* event is thus considered as an on-going situation that may be affected by the subsequent behaviour of all parties.

51. Rarely do contracts explicitly provide sanctions for the failure to give notice. While this issue may be solved as any other interpretative or gap-filling issue, it is reasonable to assume that, consequently, the party will be prevented from relying on *force majeure*. Failure to give further notices or to exercise all due diligence to minimise its effects, on the other hand, may give rise to autonomous rights to damages.

B. Effects on the contract as a whole

1. Termination of the contract

52. Contracts, or less frequently domestic laws, may grant to either one or both parties a right to terminate the contract based on the occurrence of a *force majeure* event. This right may be immediately available or arise only after the period in which performance was suspended has expired. Termination may also automatically ensue after a specified period of time, particularly when the contract contains a list of events permitting an automatic termination and specifically includes the impossibility to perform due to *force majeure* events. The right to terminate the contract may also be conditioned on giving notice to the other party. Moreover, the contract may expressly determine the effects

⁸ For international commercial contracts, a similar rule can be inferred from Art. 7.4.8, UPICC and, for international commercial sales from Art. 77, CISG.

of termination, for example by limiting it to future performances (see Chapter 6 at para. 38 and Chapter 5 at para. 26).

53. Termination is furthermore often provided, either alternatively to other remedies or only in specific cases (for example, when a renegotiation fails, see below, at Section 2) in clauses addressing exceptional changes of circumstances that render performance more onerous for one of the parties.

2. Right or duty to renegotiate

54. That parties may wish to continue their relationship even when unforeseen circumstances impede or severely restrict performance is one of the most interesting aspects of long-term contractual relationships. To achieve such continuation, a clause of the initial agreement may provide a right or a duty to renegotiate its terms upon occurrence of a specified event. This is typically the case when contracts contain clauses covering exceptional circumstances that do not render the performance impossible. Sometimes, however, this remedy is provided in *force majeure* clauses, thus deviating from the traditional understanding of the consequences of *force majeure*.

55. Renegotiation is often the only consequence stipulated by the parties when they refer to “adverse factors” with no further specification.

56. Renegotiation clauses are particularly useful in long-term contracts for emphasising the importance of a continuous cooperation. When parties wish to include such a remedy, it is advisable that they also specify the consequences of a failure to enter into renegotiations in good faith or to reach an agreement. The intervention of a mediation board or analogous body may facilitate the parties’ task in this respect, as discussed in Chapter 7 on Dispute Resolution at paras. 20-29.

57. Parties may also wish to ensure that their contract be periodically revised through negotiation, independent of the occurrence of any supervening event. This kind of provision constitutes a very useful risk mitigation mechanism, which is further addressed above at para. 18.

58. In the absence of a provision on renegotiation, the parties may always decide to modify their original agreement or conclude another one by mutual consent. Domestic contract laws, however, will not usually provide a right or a duty to enter into a renegotiation process following the occurrence of a *force majeure* event. Some legal systems on the other hand recognise that changes in the original circumstances

existing at the time of the contract's conclusion may exceptionally give rise to such a right or duty.⁹ This may derive from an express legislative provision or from the general principles of good faith, solidarity or cooperation.

3. Judicial adaptation

59. Finally, the possibility for a court to intervene and adapt the contract to the new circumstances should be mentioned. Generally, domestic contract laws do not favour this outcome. Legislative provisions on *force majeure* do not usually foresee any judicial intervention for the purpose of reallocating the risks between the parties.

60. However, some legal systems give one or both parties the right to petition a court to this effect when an unforeseeable and uncontrollable change of circumstances arises. It is important to note that such an outcome is in practice the least likely to occur when other options are available to the court, for example by fostering renegotiation proceedings between the parties or terminating the contract.

⁹ For international commercial contracts see the difference between Arts. 7.1.7 (*Force majeure*) and 6.2.3 (*Effects of hardship*).

CHAPTER 5 – REMEDIES FOR BREACH

I. Overview of remedies

1. As used in the *Guide*, the term “remedy” refers to any legal measure provided by law or by contract to protect the interest of an aggrieved party against the consequences of another party’s non-performance. When the act or event causing non-performance is not under the sphere of control of the obligor (the party responsible for performing an obligation), non-performance may be excused. (see Chapter 4 at para. 6. However, when non-performance is not excused because it resulted either from intentional acts of the obligor (*e.g.* side-selling) or from events falling within the obligor’s sphere of control (*e.g.* insolvency), the non-performance amounts to a breach of contract. The law makes the obligor in breach liable for non-performance and provides remedies to the aggrieved party.

2. This Chapter covers remedies provided against contract breach (*i.e.* unexcused non-performance). As a general rule often applied at the international and domestic level, when non-performance is excused for the occurrence of impediments beyond the control of the non-performing party, either party can resort to any remedy other than claiming damages.¹ While some remedies (namely money damages) are exclusively designed for breach, many other remedies are available both in cases of excused and unexcused non-performance, as long as the circumstances excusing non-performance do not impair their use. For example, *force majeure* may or may not exclude specific performance depending on whether impossibility of performance is final or temporary. Remedies can require cooperation by the aggrieved party when the objective is to continue the relationship and restore compliance. Cooperation is not necessary when the aggrieved party wants to search for market alternatives and seeks contractual termination.

¹ For international sales contracts, a similar rule is stated in Art. 79(5), CISG.

3. In many – albeit not all – legal systems, the remedies available to the aggrieved party have to be commensurate to the seriousness of the breach. Some legal systems limit the use of more severe remedies (such as contract termination) to instances in which the breach: substantially deprives the aggrieved party of what it was entitled to expect under the contract (within the limits of foreseeability); is intentional or reckless; or is such that the aggrieved party has no reason to believe that any performance will be forthcoming.² The *Guide* refers to these situations of particularly serious breach, which may be known domestically as a “material” or “substantial” breach, as a “fundamental” breach.

4. This Chapter considers remedies conditional upon judicial intervention, non-judicial remedies that can be applied by private enforcers (*e.g.* arbitrators, dispute resolution mechanisms, trade associations, certifiers, etc.), and self-enforcing remedies directly applicable by the parties. Non-judicial remedies are typically administered by private dispute resolution bodies to which the parties have referred directly in the contract or indirectly when they incorporated by reference codes of conduct or technical standards associated with specific dispute resolution bodies (see Chapter 7 for further discussion of dispute resolution options). These remedies complement conventional contractual remedies designed by the parties, and broaden their scope and functions. They may also interplay with non-legal sanctions (*e.g.* reputational sanctions), thereby increasing their effectiveness. But the use of a legal remedy does not necessarily imply litigation or resorting to court or an independent third-party enforcer, and some legal systems allow so-called “self-executing remedies”, which are directly activated by the aggrieved party. In addition, parties may *ex post facto* agree on the measures to be taken in case of a breach, especially if an amicable solution allows the parties to correct mistakes, avoid future ones, or limit the negative consequences of a breach. When the parties do not agree on a solution, they might take other types of decisions. Some lead to litigation or judicial intervention (starting arbitral or court proceedings), and some do not (such as when parties resort to mediation or merely terminate the contractual relationship on a private basis).

² For international commercial contracts, the UNIDROIT Principles reserve the remedy of termination to instances of fundamental breach (see Art. 7.3.1, UPICC). For international sales contracts, the CISG takes the same approach (see Art. 25, CISG).

5. The legal sources for provisions on remedies can be found primarily in the contract itself, in framework contracts as well as in the applicable law that can limit or enhance contractual freedom. Parties may also incorporate standards by reference (see Chapter 1 at paras. 26-30), and non-compliance with those standards may require specific remedies. The applicable law may provide for specific limitations, restricting the use of remedies (*e.g.* the use of termination in cases in which specific investments have been required by contractor) or enlarging the array of available measures (*e.g.* penalties applicable to contractual breaches).

6. 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. Parties to a contract may choose whether to include in the contract the conditions under which each specific remedy may be used or to leave that choice to the aggrieved party. They may (a) limit the number of available remedies (for instance by waivers of liability or exoneration clauses that bar certain types of damage or compensation claims); (b) modify the content and scope of remedies stated in the law; and (3) allocate remedies allowing only one party to be able to seek that remedy. However, the freedom to define and limit remedies may not be unconstrained. Such deviation from default rules may not be permitted, in order to protect weaker parties, under applicable contract law (*e.g.* on unfair contract terms), competition law, sector-specific law (*e.g.* agricultural law), or more recently under unfair commercial practises law when there is a high level of power asymmetry in the parties' relationship.

7. Furthermore, 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). Remedies apply both to breaches related to product and process standards and differ in content and scope. Product standards concern the physical characteristics of the final product with special regard to quantity, quality and safety. Process standards are concerned with the process through which the goods are produced (method of production, technology used, working conditions) and may also encompass environmental and social obligations with which the producers have to comply during production processes. The degree of

interdependence between the two standards varies, influencing the link between remedies for violations of process standards and product non-conformity. Process standards often apply to the entire supply chain, forcing stronger coordination among chain participants when a breach occurs. A clear illustration is provided by product traceability, which requires parties to identify lots and batches, and keep processing and distribution records through a single portal or platform (see Chapter 3 at para. 115). Breaches related to traceability obligations entail collaborative efforts among parties of numerous contracts beyond production including processing and distribution.

8. Likewise, certification and quality assurance programs may require producers to create a complete control and monitoring system to ensure compliance, including the activities performed by subcontractors (see Chapter 3 at paras. 105-108). Breach of these obligations may call for remedies that force the producer to set the monitoring system up or to redefine its structure to implement the process standards. The main aim of these remedies is to ensure compliance with the scheme rather than warrant compensation for the aggrieved party.

9. Lastly, remedies might serve the mere purpose of imposing pressure for future performance. This happens when one party is entitled to withhold its own performance due to the breach of the other party (*e.g.* the producer withholds delivery until the contractor offers the first instalment payment, if due before or upon delivery). Whether withholding performance may induce the other party to comply or be a mere prelude to future termination (see below at 18-20) will vary from case to case.

A. *Different types of remedies*

10. Remedies may be classified into three broad categories according to their content and to the extent to which they are apt to ensure compliance with contractual commitments. As a first category, some remedies, known as in-kind remedies, aim to provide the aggrieved party with the same or equivalent benefit expected from contract performance. These may include: specific performance (*i.e.* performance of the specific duty provided by law or contract, such as an order to take immediate action to plant particular seeds within a specific time frame); removal of defects via repair or corrective actions; and replacement of non-conforming goods. When these remedies are used, the contractual relationship remains in place and normally any other loss arising from

the breach despite the application of the in-kind remedy (*e.g.* loss for delay in performance) is covered by awarding damages to the aggrieved party. The use of in-kind remedies may be particularly relevant in any of the following situations: when parties have realised specific investments hardly re-deployable in other relations; when there is a strong interdependence among performances along the supply chain; when the aggrieved party may not reasonably find adequate alternative solutions in substitute transactions; and when non-compliance does not only produce monetary losses but also non-monetary ones (*e.g.* reputation losses).

11. As a second category, there are some remedies that do not provide the aggrieved party with the same kind of expected benefit, but a monetary value replacing the expected benefit. This is the logic, for example, behind damages as a stand-alone remedy or a price reduction in the case of defective or partial performance. Monetary remedies may be particularly relevant when the aggrieved party can easily engage in cover transactions by accessing the market to sell products that, though non-conforming, can still be sold, or by purchasing inputs or products available in the market.

12. Lastly, a third category encompasses situations when the consequences of the breach are severe (*e.g.* in case of fundamental breach), such that there might be no room for continuing the contractual relationship. In these situations, depending on applicable law, the aggrieved party may seek contract termination and monetary redress. The consequences of termination consist of dissolving the contractual relation, thereby extinguishing the parties' original obligations. In cases of partial or total performance by the aggrieved party, restitution of the value conferred by such performance may be sought. Depending on applicable law, termination may leave some outstanding obligations intact and parties may be held in breach of these obligations even after termination (see Chapter 6 at paras. 38-39).

13. The extent to which each remedy may be used and the way legal systems prioritise remedies or build possible forms of escalation may greatly differ from one legal system to another and across markets. Relevant variables relate to the size of the producer, type of commodity, and domestic or international markets. Increasingly, differentiation introduced by domestic law concerns the size of producers (special regimes for smallholders and microenterprises have been introduced), the type of commodity (its life cycle, its re-deployability in secondary market), and market structure (its degree of concentration). Remedies

differ also in relation to the burden of proof. Recovering damages generally requires proof of breach, harm and causation. The other remedies generally require only proof of breach (see below at para. 33 *et seq.* for further discussion).

14. Choice and content of remedies can depend upon causation and the aggrieved party's conduct. Legal systems differ on definitions and applicability of contributory and comparative negligence and on the duty to mitigate damages. In some legal systems, the fault of the aggrieved party excludes the possibility of seeking some categories of remedy (*e.g.* specific performance) while, in others, it affects the amount of damages for the breach (see below at para. 41-43 for further discussion).

1. Remedies in kind

15. Remedies in kind include the right to performance, repair, replacement and corrective actions concerning the production process and the final product. They aim to achieve the results that the parties had envisaged, or at least a cooperative second best solution when the initial terms of the exchange cannot materialise. While the remedy of repair might be of limited use for agricultural commodities and for livestock, other types of corrective action can be useful in the context of agricultural production contracts and help to re-establish compliance with binding standards. In particular, process-related in kind remedies are often sought by quality assurance or certification programs when the certified producer breaches the contract (see Chapter 3 at para. 108). Once in place, such remedies play the double function of ensuring compliance with certification requirements and preventing the producer's future breach for product non-conformity. They may encompass warnings, corrective measures or other actions, suspension, and cancellation of certification.

16. Applicable law may restrict the use of the in-kind remedy of specific performance where (1) it is not physically possible (*e.g.* goods to be delivered have been destroyed); (2) unreasonably burdensome (*e.g.* tons of specialty seeds, due to be segregated from ordinary seeds, have in fact been commingled); (3) legally unenforceable for its exclusively personal character (*e.g.* technical assistance concerning a new agricultural methodology only known by a specific provider); or (4)

because the aggrieved party's request has not been timely.³ The occurrence of harm is not a prerequisite to obtain specific performance, nor does the breach need to be fundamental. Furthermore, depending on applicable law, the possibility to claim replacement of goods may be restricted as a fundamental breach might be a prerequisite to application of this remedy.⁴

17. The request for specific performance, repair or replacement may be made on a private basis (directly between the parties without the intervention of a judge or arbitrator), through a court, or through an alternative dispute resolution mechanism, such as arbitration. Execution of a judicial order or arbitral award for specific performance will depend on applicable law. A court order, for example, may be accompanied by imposition of a penalty for non-compliance or a delay in complying.

2. Withholding performance

18. Depending on the applicable law, the remedy of withholding performance may either be used when one party breaches the contract before the aggrieved party has to perform pursuant to the contract schedule; or, in case of anticipatory breach, when circumstances make it apparent that there will be a fundamental breach.⁵ The impact of withholding performance on the development of the contractual relationship may depend on the type of performance withheld.

19. Thus, when the contractor commits to pay the full price or part of it in advance (see Chapter 3 at paras. 87-91), failure to pay may justify the producer's withholding of counter-performance (*e.g.* refraining from making requested investments for which advance payments were to have been made). By the same token, payment of the price may be withheld when the producer fails to deliver any goods or delivers non-conforming ones (see Chapter 3 at paras. 124-143). In these cases, withholding performance represents an instrument for enforcing or inducing the exchange.

20. However, withholding performance may also play a different function with respect to obligations instrumental to the other party's

³ For international commercial contracts, a similar rule is stated in Art. 7.2.2, UPICC.

⁴ For international sales contracts, a similar rule is stated in Art. 46(2), CISG.

⁵ For international commercial contracts, a similar rule is stated in Art. 7.3.4, UPICC and, for international sales contracts, in Art. 71, CISG.

performance (*e.g.* the contractor's provision of technical assistance, which enables the producer to install new harvesting machinery) (see Chapter 3 at paras. 92-94). This instrumentality plays an important role in cases where the producer and contractor engage in a common interest project as part of a long-term relationship, such as making specific investments (*e.g.* experimentation on a new agricultural technique calling for the purchase and use of new technology) (see Chapter 3 at paras. 75-76). In these cases, parties may decide to withhold interdependent performances in order to prevent losses and errors in the accomplishment of the common project (*e.g.* no machinery will be installed without technical assistance), whereas they may refrain from withholding performances if this could hinder such accomplishment (*e.g.* producer has sufficient knowledge to install the machinery even without the contractor's technical assistance and delay in machinery installation could undermine the project outcome).

3. Price reduction

21. Conceptually, price reduction stands between contract adjustment and remedies. A price reduction can occur when there is uncertainty about the criteria to determine quality and quantity or as a reaction to a breach. If parties are uncertain about the future quality they may define criteria that correlate different qualities and different prices. In fact, quite often parties retain the power to determine or adjust the price in accordance with the actual quality of the product when it is more clearly ascertainable (*i.e.* after production or even at time of delivery). Such adaptations do not presuppose a breach. For this purpose, grading systems may be provided within a single contract or supply chain, or incorporated by reference to external sources that are generally applicable to a given market or a sector (see Chapter 3 at paras. 47-56). This section examines price reduction as a remedy against breach of contract.

22. Price reduction is a typical remedy in case of breach for non-conformity or for partial delivery.⁶ Indeed, its function is to preserve the exchange and restore the balance between the values of the exchanged performances. It is used when one of the two performances is defective or incomplete and the aggrieved party is not interested in (or may not

⁶ For international sales contracts, a similar rule is stated in arts. 50-51, CISG.

obtain) specific performance, nor contract termination. In agricultural production contracts, depending on the applicable law, this remedy may be applied: (1) when the producer fails to deliver conforming inputs; (2) when the contractor has to pay the costs of these inputs contrary to the contractual initial allocation; or (3) when the producer fails to deliver conforming agricultural products that could still be used by the contractor (*e.g.* being sold through secondary or tertiary markets). A fundamental breach and damage are not normally prerequisites to seeking a price reduction. But, depending on applicable law, price reduction may be barred by the obligor's right to cure defects, when recognised by law⁷ (see below at paras. 44-45).

4. Termination

23. Contract termination can be conceived of as both a choice and a remedy. This section considers termination as a remedy for breach (see also Chapter 6 on termination). Contract termination can be seen as the most severe remedy against any party's breach because it definitively reflects the failure of the contractual relationship. The aggrieved party acknowledges that there is no room left for cooperation within that relationship, and chooses to seek alternative options in the market (if any). But, the threat of termination may provide powerful incentives to negotiate when breaches or potential breaches occur. Often parties define termination clauses that confer a unilateral right to terminate the contract when a breach occurs. Termination can have additional effects beyond the specific contractual relationship (such as the end of participation in a particular supply chain with a ban on contracting with other parties participating in the chain, or even broader consequences when termination comes with blacklisting that bans contracting with all market participants).

24. In many legal systems, although not all, domestic law requires a breach to be fundamental before an aggrieved party may terminate the contract. In long-term relationships, especially when several parties join the contract, parties may even agree in advance that termination may not be sought before a certain lapse of time, during which the parties are expected to cooperate. The more the relationship includes elements of strategic cooperation, the more the parties will prefer to make

⁷ For international sales contracts, a similar rule is stated in Art. 50, CISG.

termination dependent upon an exceptionally serious breach. Domestic legislation has often limited parties' ability to terminate contracts when significant investments are made. When grounds for termination arise, damages for unexcused breach become an almost necessary complement to this remedy. In fact, termination does not provide any substantial satisfaction to the aggrieved party besides restoring the aggrieved party's freedom from contractual obligations and therefore its ability to seek alternative transactions.

25. Legal systems differ with respect to the procedure needed to terminate a contract. Depending on the applicable law, the producer may need to file a claim in court, or a written notice directed to the other party may suffice. Applicable law may allow the parties to follow an extra-judicial procedure if termination clauses are included in the contract (enabling termination by notice) or, if a notice is formally addressed to the party in breach, assigning a period of time for performance. Legal systems also differ about the time by which the notice of termination should be given to the party in breach. At the international level, the aggrieved party is required to provide notice within a reasonable time after becoming aware of the breach.⁸ The use of notice is important when it is coupled with a grace period, in which the contractor may perform, thereby preventing termination from occurring, at least for that period. This last resort remedy may play an important function in long-term agricultural production contracts or in contracts with important investments by either party.

26. Contract termination generally releases parties from the obligations arising from the contract (duty to provide inputs, to process, to deliver, etc.) but not post-contractual obligations, which may persist even after termination (*e.g.* duty to maintain confidentiality or to refrain from using certain IPRs) (see Chapter 6 at para. 38-39). If the contract is terminated and an obligation has not been executed, performance is no longer due. If it has been executed or partially executed, restitution is due to the party who performed, possibly in kind or in money. When based on breach, termination does not normally preclude any claim for damages. It does not affect any provision in the contract for dispute settlement or governing the parties' rights and obligations following termination or

⁸ For international commercial contracts, a similar rule is stated in Art. 7.3.2(2), UPICC and, for international sales contracts, in Art. 64(2)(b), CISG.

breach (*e.g.* duty to pay penalties for contract repudiation or duty to mitigate damages occurred from the breach).⁹

27. Termination can be total or partial. Where the contract consists of a series of obligations (for example instalments) and one party fails to perform one of these obligations, depending on the applicable law, the aggrieved party may not have the right to terminate the whole contract. In instalment contracts, for instance, if one of the due instalments is grossly non-conforming, whereas all the others are conforming to contract specifications, termination could address the non-conforming instalment only. Depending on whether termination is total or partial, all obligations or only some will be affected by termination. Only performances affected by termination need to be returned. Indeed, in the case of total termination, because parties are released from all obligations, if some have already been performed, these must all be returned (see below at paras. 28-32). In case of partial termination, obligations not affected by termination (*e.g.* past instalments of banana deliveries) remain in place and performances not affected do not need to be returned.¹⁰

5. Restitution

28. Restitution implies that a party who is not entitled by contract or by law to retain goods or money in its possession must return them to the owner. In this Chapter, restitution remedies are only considered to the extent that they serve to restore a balance in the parties' economic relationship, which has been altered because of the breach and consequent contract termination. The scope of restitution remedies depends on the nature of completed performance, whether consisting of money, agricultural products, or services.

29. When performance consists of the provision of goods or services (non-monetary performances), upon total or partial termination they should be returned in kind, unless such restitution is not physically possible. If restitution in kind is not physically possible, then legal systems may provide that restitution should occur in money unless: (a)

⁹ For international commercial contracts, a similar rule is stated in Art. 7.3.5, UPICC and, for international sales contracts, in Art. 81(1), CISG.

¹⁰ For international commercial contracts, a similar rule can be inferred from Art. 3.2.13., UPICC.

the restitution in kind is impossible for reasons that depend on the party claiming for restitution, then no restitution in money is due¹¹ (*e.g.* a harvest machine had been lent to the producer by the contractor but was then used by one of the producer's employees and damaged); or (b) the executed performance has brought no benefit to the recipient¹² (*e.g.* the harvest machine never worked since delivery and after a short period was destroyed by a hurricane).

30. However, in an agricultural production contract, the real possibility of providing restitution in kind might be rather limited depending on whether the object of the performance was goods or services. With regard to the former, two main objects should be considered: inputs provided by the contractor (see Chapter 3 at paras. 73-77) and agricultural products (see Chapter 3 at Section II. A. "The product). Physical inputs, in principle, should be returned to the contractor. However, depending on the stage of production, they might have been already incorporated into the product (*e.g.* seeds planted, pesticides used, feed for animals used, etc.), which makes a restitution in kind impossible. In this case, if the agricultural product stays with the producer, the producer might be requested to pay the contractor for the value of the inputs used, unless any reduction or exemption can be requested for their non-conformity. By contrast, when incorporation has not yet occurred, the producer might be able to return in kind physical inputs that have been received but not yet used, as well as any infrastructure, machinery or equipment that might be moved off the producer's property without unreasonable effort and costs. If the contract had provided for the use of the contractor's land, depending on applicable law, use of such land should be returned to the contractor.

31. Usually the contractor is entitled to the agricultural products only in the final stage of contract performance, whereas before then the producer retains title and possession over those outputs. In this case, depending on applicable law, if the contract is terminated, both title and possession may rest with the producer, who will retain agricultural products, including crops and livestock, without being obliged to make any restitution. However, it could happen that the contractor has retained

¹¹ For international commercial contracts, a similar rule is stated in Art. 7.3.6(3), UPICC.

¹² For international commercial contracts, a similar rule can be inferred from Art. 7.3.6(2), UPICC.

ownership over the land, the seeds or the livestock, so that, when contract is terminated before the ordinary expiration date, these goods and the outputs produced thereof have to be returned to the contractor. In practise, if the contractor has terminated the contract upon rejection of non-conforming goods, it may prefer to claim no restitution. In other cases, for reasons linked with property rights in seeds (see Chapter 3 at paras. 95-104), it may request the goods to be returned or destroyed even if they are non-conforming. Effective restitution may be also hindered by a possible lien or retention right that the contract or the law may assign on these assets to the producer in order to secure contractual obligations (*e.g.* the contractor's obligation to pay the price).

32. When the performance consists of services (*e.g.* agronomic services, training services, etc.), restitution in kind is obviously not possible. Depending on applicable law, restitution in money should be considered reasonable to the extent that the services have brought some effective value to the recipient despite the subsequent termination and were not rendered as merely instrumental for the specific production affected by termination (*e.g.* training program gratuitously provided by the contractor for its producers). Indeed, this service provision would often represent a mere cost or investment borne by one party for the best execution of the contract and not a performance rendered to the other for consideration. Moreover, when technical assistance constitutes one part of the contractor's performance (see Chapter 3 at paras. 92-94), this mostly occurs within long-term contracts in which termination may not apply to performances that are separable from those affected by the breach or the other event causing termination (*e.g.* force majeure). Therefore, once the part of the contract affected by any such event (*e.g.* a single instalment) has been terminated, the agricultural production contract as a whole remains in force and technical assistance may be received by the producer without any obligation to make restitution in money.

6. Damages

33. Damages may be sought as a stand-alone remedy or in combination with other remedies,¹³ and their function changes accordingly. Pursuant to most legal systems, an aggrieved party to an

¹³ For international commercial contracts, a similar rule is stated in Art. 7.4.1, UPICC.

agricultural production contract may always claim damages insofar as non-performance is unexcused. When damages are sought as a stand-alone remedy, the objective is normally to put the aggrieved party in the position it would have been had the contract been performed. For example, as a stand-alone remedy, damages typically include costs incurred and lost profits.

34. Generally, the aggrieved party must prove damages. The aggrieved party generally has to prove the breach, the harm and the causal connection – unlike in other remedies where the existence of the breach may be sufficient to entitle the party with the right to seek remedy. However, some legal systems reverse the burden of proof so that it suffices for the aggrieved party to prove the breach, and it is for the breaching party to prove that no harm has been caused or that it was not caused by the breach. In order to assess whether a breach has caused damages, legal systems refer to several criteria, among which the following are most common.

- Full compensation: Full compensation requires that recoverable damages include any loss incurred (*e.g.* costs reasonably incurred by producer to store the goods in case of contractor's failure to take delivery) and gains the aggrieved party was deprived of (*e.g.* missed profits for contractor's resale of the agricultural goods).¹⁴
- Foreseeability: The party in breach is liable only for damages as a result of non-performance that were either foreseeable or could have been reasonably foreseen at the time of conclusion of the contract.¹⁵ So, for example, the costs of preservation of goods, as borne by the producer, represent a foreseeable consequence of the contractor's failure to take delivery on time, whereas the producer might not be able to recover the alleged loss of profits potentially resulting from a pending negotiation that the producer could not attend because of the breach, if this pending negotiation was not known or foreseeable by the contractor. Parties can define in detail what are foreseeable losses. Producers should be aware of the possibility of contractual provisions that provide for contractor's recovery of unforeseeable damages caused by producer's breach.

14 For international commercial contracts, a similar rule is stated in Art. 7.4.2, UPICC.

15 For international commercial contracts, a similar rule is stated in Art. 7.4.4, UPICC and, for international sales contracts, in Art. 74, CISG.

- Certainty: Compensation is due only for harm established with a reasonable degree of certainty.¹⁶ For example, the mere chance of profits that the contractor has lost due to the delayed delivery by the producer might fail the certainty test unless there was a concrete negotiation or even a binding contract for purchase with a third party.

35. If damages are owed, then all damages should generally be recovered, including both actual losses (*e.g.* costs incurred by the producer to replace non-conforming inputs provided by the contractor) and lost profits (*e.g.* price reduction suffered in linked transactions in which the producer has rightfully used non-conforming inputs provided by the contractor).¹⁷ As a general rule, damages normally include the loss in value of the expected performance (though discounted for costs avoided by not having to counter-perform). This loss may not be recovered, however, if a price reduction has been obtained for the same loss in value. When the aggrieved party engages in a substitute transaction, depending on applicable law, damages normally amount to the difference between contract price and cover price (the price obtained in the substitute transaction).

36. Some legal systems also allow a different method of damages assessment whereby the aggrieved party has a right to damages based on that party's "reliance interest". This consists of expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the aggrieved party would have incurred had the contract been performed. As seen below, within the limits provided by applicable law, reliance damages could be an appropriate measure especially to protect a producer against contractor's breach (see below at paras. 139-144).

37. Parties to a contract are normally entitled by the applicable law to determine the type and amount of recoverable damages through contractual clauses. Disclaimers can define liability standards or concern damages. Parties can limit recoverable damages and modify the full compensation principle by, for example, excluding or limiting consequential damages.

¹⁶ For international commercial contracts, a similar rule is stated in Art. 7.4.3, UPICC.

¹⁷ For international commercial contracts, a similar rule is stated in Art. 7.4.2(1), UPICC.

38. Parties can also pre-define the amount of damages in case of breach. These clauses may help lowering litigations costs linked with the need to provide evidence and liquidate damages. At the same time, especially when clauses may incorporate values and costs that courts would not be able to assess (e.g. immaterial damages, costs of investments done in reliance of the correct execution of the contract, etc.), these clauses tend to induce compliance.

39. In some cases, when applicable law allows, the penalty function is prevailing and parties retain the right to claim damages in addition to penalty. However, depending on the legal system, the freedom to set monetary penalties resulting from a breach may face various bans, limits or review. Depending on applicable law, freedom of contract may also be limited with respect to the scope of disclaimers made in relation to the nature of the breach (fundamental or not), and to the conduct of the breaching party (intentional or reckless).

7. Interest and late payments

40. In some legal systems, pecuniary obligations, including price for inputs, price for products, or damages, are combined with the obligation to pay interest. Interest is often (though not always) provided by contract law both at the domestic and international level for delay of payment of monetary obligations, including those consisting of prices.¹⁸ Thus, where available, the right to interest arises whenever the party exercises the right to demand a delayed payment. If the party opts for termination, the accrual of interest may be liquidated having regard to the delay occurred in obtaining the price payment, due to time needed for the substitute transaction. On the one hand, the payment of interest does not generally require specific evidence of loss suffered by the aggrieved party. On the other hand, it does not reduce any concurrent right to claim additional damages suffered by the aggrieved party (e.g. higher penalties due to the producer in favour of a financier pursuant to financing contract terms that were known to the contractor). In the latter case, the producer is requested to provide specific evidence and the damages need to comply with the usual standards of foreseeability and certainty.¹⁹ Both at the

¹⁸ For international sales contracts, a similar rule is stated in Art. 78, CISG and, for international commercial contracts, in Art. 7.4.9, UPICC.

¹⁹ For international commercial contracts, a similar rule is stated in arts. 7.4.3 & 7.4.4, UPICC.

domestic and international level, an issue arises on which interest rate should be applicable to pecuniary obligations when there is a breach.

B. The role of the aggrieved party's conduct

41. Remedies are sought against the party in breach. But, depending on the applicable law, the behaviour of the aggrieved party may (a) influence access to specific remedies; (b) deny certain remedies; or (c) reduce the scope of remedies. The aggrieved party may have contributed to the breach (under certain legal systems, this is known as comparative or contributory negligence²⁰) or the aggrieved party may have failed to mitigate the negative consequences of the breach (under many legal systems this is known as a duty to mitigate²¹). For example, if the aggrieved party contributed to the breach, it might not be able to seek termination or specific performance, or might be required to bear part of the additional costs that the breaching party will have to incur when performing. The latter can translate into price reduction.

42. The behaviour of the aggrieved party may contribute to the obligor's breach. This is the case when the aggrieved party fails to comply with obligations that could be considered to achieve the expected output. For example, a non-conforming good may result from poor agricultural practises together with poor assistance by the contractor, who was obliged to provide technical services under the contract but failed to do so. When the aggrieved party subsequently seeks damages, its own contribution to the breach may reduce recoverable damages according to the degree of fault of each party and the causal link between acts or omission and defective performance.²² In order to promote cooperation and to avoid opportunistic behaviour, some systems may only make certain remedies available to the aggrieved party that contributed to the breach.

43. An aggrieved party's duty to mitigate the consequences of the breach is widely accepted by both domestic systems and international law, although divergences exist. Compliance with this duty normally implies the right to recover expenses reasonably incurred to mitigate the harm caused by the breach. When recognised by law, failure to mitigate

20 For international commercial contracts, a similar rule is stated in Art. 7.1.2, UPICC.

21 For international commercial contracts, a similar rule is stated in Art. 7.4.8, UPICC.

22 For international commercial contracts, a similar rule is stated in Art. 7.4.7, UPICC.

prevents the aggrieved party from receiving full compensation of damages or to claim those damages due to such failure. Special attention is paid to timely substitute transactions as a means to reduce the extent of increasing losses due to price fluctuations. The duty to mitigate operates not only in bilateral, but also in multiparty and linked contracts. Clearly, multiparty and linked contracts may require some adjustments when defining the scope and objectives of the duty to mitigate, as more parties may be in a position to take mitigation measures against the occurrence of loss.

C. *The breaching party's right to cure*

44. Legal systems often give the party in breach some right to attempt to fix the breach before the application of remedies. This is typically the case of performance or cure coming after a breach has been committed and the time for performance has expired, whereas cure or substituted performances before the time in which performance is due are recognised to an even larger extent by domestic legal systems and international contract law.²³ For instance, the producer is generally allowed to cure defects if goods' inspection has occurred before the due date for delivery and non-conformity has been detected (see Chapter 3 at paras. 135-143). After the time for performance has passed, the right to a last attempt to perform is recognised by some legal systems but not by others. Where recognised, it may be conceived as a precondition for contract termination, and more rarely for other remedies. It may also be defined as a procedural defence for the party in breach, to whom a notice should be directed enabling a chance to perform before termination is declared. Where admitted by applicable law, the right to a last attempt to perform could take the form of a right to repair or to replace previous defective performance when a former unsuccessful attempt has been made (*i.e.* right to cure).

45. Where recognised, the right to cure normally suspends the aggrieved party's right to resort to remedies other than withholding performance and claiming damages caused or not prevented by cure.²⁴ Termination, as well as price reduction, may therefore be precluded. Moreover, provided that a right to cure exists within the limits described

²³ For international commercial contracts, a similar rule is stated in Art. 7.1.4, UPICC and, for international sales contracts, in Art. 37, CISG.

²⁴ For international commercial contracts, a similar rule is stated in Art. 7.1.4, UPICC.

above, the choice between repair and replacement could be controlled, through the right to cure, by the non-performing party rather than by the aggrieved party.

D. Renegotiation

46. Although the contract might have provisions allocating risks and liability for a particular breach, practical circumstances may suggest that remedies provided by the contract are not consistent with the parties' interests due to the occurrence of new facts and circumstances. Cooperation after a breach is fundamental to preserve material and non-material investments. For example, an agricultural production contract may provide that a breach of a specific obligation (*e.g.* failure to obtain certification for a given input, process or output) can cause immediate termination of the contract. In fact, parties may subsequently agree that such failure is only temporary and that incurred costs and investments would be lost in case of termination. At the same time, the failure to obtain certification may require a specific adaptation of the contract as the parties may agree on the delivery of non-conforming produce to a market different from that originally indicated. They could also agree on the adoption of a corrective plan in order to enable certification for future instalments (see Chapter 2 at para. 55). In these circumstances, renegotiation can provide an opportunity to safeguard specific investments and ensure the continuity of contractual relations.

II. Contractor's remedies for producer's breach

47. Producers have to comply with obligations related to product and process standards. Several obligations, known as "product-related" obligations, are directly concerned with the physical characteristics of the goods to be produced (quality, safety, quantity, delivery time) or the corresponding remuneration due for them (price, time of payment) (see Chapter 3 at para. 2). Within product standards, reference is made to both products and services, because for some commodities (livestock and aquaculture), production contracts related to service rather than product supply (see Introduction at paras. 8-12).

48. Assuring that production complies with process-related standards required by the contract and good agricultural practices is one of the producer's primary responsibilities (see Chapter 3 at paras. 105-117). Process-related obligations are those that are concerned with the process

through which the goods are produced (method of production, technology used, working conditions). Some of them may be more directly aimed at achieving the goods' desired physical characteristics (*e.g.* quantity and manner of using fertilisers, use of pesticides, hygienic conditions), whereas others may only remotely relate to product quality in a physical sense and be more closely associated with intangible attributes sought for the product or the process (*e.g.* compliance with environmental and sustainability standards, community benefits, gender and indigenous population concerns) (see Chapter 3 at para. 2). Breach of these obligations may give rise to remedies distinct from those related to product non-conformity.

49. While common principles characterise product-related and process-related remedies, there may be a different sequence of remedies and some of them may be excluded. For example, whereas for product-related obligations termination is normally subject to the prerequisite of fundamental breach, it is generally excluded in process-related obligations where remedies are mainly aimed at restoring compliance while preserving the relationship.

50. In many legal systems, the producer is liable for events within its control, whereas it is exempted if the impediment to performance is outside its sphere of control. Control presupposes foreseeability or avoidability of the impediments (see Chapter 4 at paras. 21-24). If the producer can foresee the risk that an event can make performance more expensive or commercially impracticable, the producer assumes that risk, unless the contract specifically provides for exemption by referring to force majeure or excuse. Typically unavoidable, even when foreseeable, events include some natural events (*e.g.* floods, frosts, droughts, and earthquakes), regulatory changes at domestic or international level, and changes in market structures and prices. Similarly the event rendering performance more onerous will be considered under the producer's control if it can be avoided by undertaking actions even if they may significantly increase the cost of performance. Avoidable events include both those that require additional precautionary measures and corrective actions once the impediment has occurred. When the producer's liability is exempted, various contractual options are available: contract termination, performance-based remedies (including payment of prices for inputs received by the contractor), restitution (see Chapter 4 on Excuses for Non-Performance). Especially in long-term contracts, where exemption may be limited to a single performance, the availability of

other remedies (*e.g.* the right to performance), concerning process-related obligations could be highly important.

51. Remedies for the contractor range from the right to performance to termination and vary in context and scope according to their legal basis, be it the applicable law, codes of conduct that the parties have incorporated into the contract, commodity exchange regulations when trading occurs in regulated markets, or certification regimes. Private programs often add other forms of sanctioning, based on reputation and membership, ranging from warning to expulsion and using grey and blacklisting. Remedies can often be combined. Damages claims, for example, can be combined with other remedies or sought alone. The burden of proof varies depending on the remedy sought (see above at para. 34). The following sections will outline the principal remedies available to contractors after a producer breaches its obligations under the agricultural production contract.

A. Remedies in kind

1. Breach of process-related obligations

52. Process-related obligations may be more or less closely related to product non-conformity and have different content depending on the provider (see above at para. 49). For input provisions, they are clearly linked to product conformity, whereas for obligations related to community interests or social standards, the link is looser or non-existing. In some instances, non-compliance can undermine the ability to deliver conforming products, whereas in other instances the breach might not have significant influence on the producer's main performance. Remedies for breach of process-related obligations tend to preserve the relationship and often require the aggrieved party's cooperation.

53. When the contractor identifies violations related to input provision by the producer or by third parties (see Chapter 3 at paras. 71-72), the contractor does not have to wait until delivery to take action. Remedies can often be sought before product non-conformity materialises. They can be aimed at either repairing or replacing the input or modifying the production process to ensure product conformity despite the defective input. Process-related obligations may be breached before delivery of the final product, but also after delivery, for example, when information for traceability purposes is not properly stored and made accessible to the contractor or third parties (such as certifiers) (see Chapter 3 at para. 115).

Breach can even occur after contract expiration, when certain process-related obligations survive the contract.

(a) Right to performance

54. Process-related obligations may require the producer to engage in activities that follow multiple stages until process completion. The contractor may be able to require performance to ensure compliance with the process standard. It may ask that processes be consistent with good agricultural practices, comply with technical instructions provided in the manuals, and have reduced negative effects on the environment. Without compliance, the producer might not be able to obtain certification, thereby undermining the final product's value and its marketability. Within the production process, the influential role played by the contractor in monitoring, providing guidance and exercising control, requires cooperation and communication between the parties (see Chapter 3 at paras. 118-123). The right to performance may concern activities or conveying information about the process or product, with special regard to safety and quality (see Chapter 3 at paras. 42-59).

(b) Corrective actions

55. Corrective measures are often sought when there is a violation of a technical standard that includes process-related obligations. Corrective measures may be required to reduce or mitigate the risks caused by the breach, in addition to performance or substitute performance if the emergence of the hazard makes the initially agreed conduct inadequate to ensure compliance. The claim for corrective action usually does not require that such violations would later result in output non-conformity. It applies both to process obligations instrumental to product conformity and those only loosely linked to non-conformity or traceability.

56. When process-related obligations concerning quality or safety are breached, the contractor may be entitled to ask for corrective actions. Corrective actions may have deep implications and go to the structure of the production process. Once the violation has been detected, the contractor can ask for modification of the production process so that the quality or safety failures are corrected. Often, this remedy is found in major retailers' general terms and conditions, which may apply to contracts throughout the supply chain. Corrective actions can materialise in action plans that modify the production process, the use of inputs, or the type of agricultural practises. Production process modifications based on an action plan may contribute to delivery of a conforming good even

if a breach has occurred. Provided that corrective actions exist to prevent or reduce non-conformity, the effectiveness of these actions will depend on timely intervention and the ability to detect hazards or quality problems. This remedy prevents product non-conformity at an early stage.

57. For safety-related obligations (see Chapter 3 at paras. 57-59), corrective actions can address both failures in risk assessment and in risk management. These remedies are aimed at solving problems in the production process where hazard detection is inadequate. Remedies may address the failure to monitor risks and properly assess the emergence of hazards when, for example, some hazards that had not been detected by the producer become apparent only upon the contractor's inspections as part of a safety management program. Similarly, for quality-related obligations (see Chapter 3 at paras. 42-56), corrective measures may be used to ensure compliance with requirements related to denomination of origin, geographical indications and other quality-related attributes.

58. The specific content of corrective action by the producer is often determined by agreement with the contractor and, when certification is involved, with the certifier. The producer may, for example, be asked to submit an action plan to modify how a critical control point operates. Such an action plan can include modifications to the production process that address the causes of potential non-conformity. Cooperation is a necessary requirement to make correction effective.

59. The most radical corrective remedy is personal substitution within the production process. In some circumstances, and upon failed attempts by the producer to attain correction, some contracts permit the contractor or third parties identified by the contractor to replace the producer at its expense when it becomes clear that the producer will not be able to perform according to the contract. Particularly in the case of livestock contracts (and to a limited degree crop contracts), this remedy allows the contractor or a third party to replace temporarily the producer and perform the activity by directly producing on the producer's premises.

2. Product non-conformity

60. One of the producer's main obligations is delivery of conforming products (see Chapter 3 at paras. 124-143). Conformity relates to safety, quality, and origin. Most legal systems provide for default rules on contractual remedies for non-conformity. In many cases the aggrieved party may choose within a menu of measures. Depending on the

applicable law, the contractor's choice of remedies for non-conformity may depend upon many factors related to: time of non-conformity's detection; availability of secondary or tertiary markets; negative effects on third parties (such as consumers) that may require differentiation between safety and quality. Among other factors, the duration of the contract and the nature of the commodity's biological cycle can affect the choice of remedy and the cooperative nature of its content.

61. Product non-conformity and hazards related to agricultural or livestock production may emerge not only before or at the time of delivery, but even long after delivery, during the production process along the chain or at the time of consumption. Remedies for non-conformity may differ depending on the time when non-conformity is detected, because the possibility to correct failures may decrease over time. Early detection by inspection may permit more significant corrections, whereas detection at the time of delivery may make corrective measures, especially for perishable goods, difficult to implement. When non-conformity becomes apparent only at a later stage, yet still before delivery, replacement, rather than repair, may become the primary remedy.

62. Significant differences related to the choice of remedies can emerge at the time of detection. Unless a case of anticipatory breach occurs, early detection may not necessarily require rejection, and the parties may wish to afford the producer the right to cure defects. By contrast, when non-conformity is detected at time of delivery, the contractor may wish to retain the right to reject the product and seek different remedies depending upon the seriousness of non-conformity, ranging from repair, to replacement, to price reduction or product downgrading or termination. Rejection as such does not strictly represent a remedy because it is a legal power enabling the contractor to access further remedies and to withhold price payment whenever payment is subject to approval of the goods. After rejection, the choice of remedies should take into account the nature of the contract and the parties' interests. Unless otherwise provided in the contract, in order to preserve investments and the relationship, especially if it is long-term, the applicable law could provide that the contractor shall first ask for repair and, only if repair is inadequate, seek product replacement.

63. It may be advisable for the parties to structure remedies according to the producer's conduct after the breach. For example, a specific time may be provided to the producer to take corrective or repair measures. If

this time expires and the breach persists, the contractor could be granted the right to choose whether to (a) accept the non-conforming goods and seek price reduction, or (b) reject them and seek other remedies, namely replacement or termination. Payment will be due in the former (replacement) but not in the latter (termination).

64. In establishing remedies for product non-conformity, it is advisable to consider the availability of secondary or tertiary markets where substitute conforming goods could be purchased and non-conforming goods sold. This possibility particularly affects the availability of the replacement remedy and the assessment of damages thereof. It may also lead the contractor to downgrade the goods and apply a price reduction with respect to lower quality products sold in a secondary market.

65. Quality and safety non-conformity can be treated differently. Both law and private standards regulate food and feed safety mainly through mandatory rules (see Chapter 1 at para 45). Safety regulation prevents producers from putting unsafe and dangerous products on the market, including intermediate markets. Agricultural production contracts cannot displace regulatory obligations that make the producer liable if safety standards are violated. A contractor seeking remedies against the producer for unsafe or dangerous products has to comply with public law requirements as well when selling the product to subsequent buyers down the chain (see Chapter 3 at paras. 57-59). The choice of remedies is therefore conditioned by the objective of minimising risks of harm for third parties in cases of non-conformity arising from breach of safety requirements. Preventive remedies can contribute to avoiding the commission of a tort and run into extra-contractual liability. For example, when non-conforming products are found to be unsafe, the contractor will wish to have the right to demand further handling of the product to reduce hazards to a degree compatible with safety requirements. The use of secondary or tertiary markets may be allowed for non-conformity with quality standards, but may not be an option for non-conformity with safety standards. Indeed, fewer constraints from public legislation may come from quality requirements, although consumer protection objectives related to quality may influence the contractor's choice of remedy. If safety is not at stake, product downgrading and the provision of clear information to consumers normally suffices as requested measures.

(a) *Corrective measures*

66. In the case of goods non-conformity, the contractor may wish to seek corrective measures. Corrective measures can refer to safety, quality, or quantity. They concern both causes and consequences of non-conformity. Although correction may be more effective if requested for violation of process-related obligations during the production process, there might be reasons for which the violation has not become apparent before inspection of the finalised (non-conforming) goods, or non-conformity is caused by external factors unrelated to the production process (*e.g.* goods infestation after production and just before inspection). Where the contractor identifies serious risks of product non-conformity at the time of delivery, the contractor may wish to retain the right to reject the goods. A wide array of measures might be provided as a result of rejection. In the in case of unsafe products, the contractor may be entitled under the contract to ask the producer to eliminate or reduce the hazards. Handling unsafe product may require reducing food safety hazards to acceptable levels or destroying them according to environmentally compliant procedures. Corrective measures have a much broader scope than product repair.

67. Among corrective measures, information and labelling may play an important role (see Chapter 3 at para. 59). For example, if a gluten-free product does not comply with the requested standards (*e.g.* gluten-free food standards), the producer could be asked to set aside non-conforming goods and label them with a warning about the risk of gluten-content in the food. The contractor can seek additional information or ask to modify the information and labels according to the corrective measures undertaken to reduce the hazards and mitigate the risks.

68. The remedy of corrective measures may include various actions (such as reviewing and determining the causes of non-conformities; identifying courses of action that will prevent recurring non-conformities; and changing the production process accordingly). Even at time of delivery, when non-conformity depends on process failures, the aggrieved party can request both corrective measures that address product conformity and, with a view to future instalments in long-term relationships, seek measures that address process failures that have caused non-conformity in the past and could occur again.

69. The contractual definition of corrective measures should ideally take into account the time when non-conformity is detected. When standards include protection of third parties, in particular consumer

protection, the aim of correction is to avoid not only economic but also personal injuries that may be caused by introducing unsafe products into the market place. Even at the time of delivery, correction is of great importance. Clearly the earlier detection occurs, the more effective correction can be. When the product's correction is not a viable option, the producer may be asked to withdraw or recall the product (see below at paras. 75-78).

(b) Repair

70. Repair has a narrower scope than corrective action. It relates to the product itself and coincides with defects making the product unfit or unsafe. It does not address the causes of non-conformity and is not a means for seeking management changes by the breaching party. There may be cases in which, when detected at the time of delivery, non-conformity may be cured by repair. For example, if the level of dryness/humidity deviates from the parameters imposed by the technical standard, the contractor may have reserved the right to demand that the product be subject to further drying processes, at the producer's expense. This remedy, however, might not be appropriate when the contractor has contributed to the breach (*e.g.* by failing to provide adequate assistance along the production process). Parties, moreover, may agree to share the costs of repair.

(c) Replacement

71. Depending on the applicable law, when repair is not viable or unreasonably burdensome, the contractor may wish to reserve the right to seek a remedy in kind by requesting goods replacement. It may be the case, however, that in several agricultural contracts, replacement by the producer is not in fact a viable option given the producer's inability to access autonomously the market and source substitute goods. Indeed, the intrinsic nature of agricultural production contracts, based on the contractor's involvement in instructing and monitoring the production process (see Chapter 3 at paras. 118-123), would be hard to reconcile with goods replacement via the market. Rather, the producer could be requested to provide the contractor with other batches of goods produced by the producer itself in accordance with contractual requirements and under the contractor's monitoring. This may happen when the produced crops exceed the quantities due under the contract and include both conforming and non-conforming goods, thus enabling replacement of the latter with the former. This could occur, for example,

when the producer is a cooperative or a producers' group and replacement is sought among participants to the group. Alternatively, the contract may allow the contractor to engage in a "cover transaction" and then claim damages for the possibly higher price or lower quality.

72. A special case occurs when the contractor retains ownership of crops or livestock (the latter more frequently than the former), but the producer has been able to grow both the contractor's and its own livestock under the contractor's instruction. In these circumstances, the contract could provide for a cross replacement enacted by replacing the contractor's non-conforming livestock with the producer's conforming livestock.

3. Failure to deliver the product

73. Delivery of non-conforming goods differs from a failure to deliver (see Chapter 3 at paras. 124-143), as the content of the remedy (and potentially the sequence of remedies) can change accordingly. Failure to deliver the product includes: total lack of delivery; delayed delivery; delivery at the wrong place; and partial (incomplete) delivery. In all of these cases, the contractor may have an interest in requesting performance.²⁵ However, certain circumstances may prevent the use of specific performance, namely: the perishable nature of the goods, which could undermine the function of specific performance if delay in delivery reduces the goods' value to zero; the preservation costs, depending upon the length of the delay and the nature of the goods; and the transportation costs, especially in the case of delivery at the wrong place. If these impediments do not preclude the exercise of the right to performance,²⁶ this remedy could be particularly important when goods have been produced following specific requirements or using special quality inputs that make them unique or difficult to replace with a cover transaction.

74. Whether and to what extent it is appropriate for the contract to afford the contractor the right to refuse partial delivery and insist on full delivery may in some systems depend on whether full delivery was essential in the contractual relationship (*e.g.* the contract clearly

²⁵ For international commercial contracts, a similar rule is stated in Art. 7.2.2, UPICC and, for international sales contracts, in Art. 46, CISG.

²⁶ For international sales contracts, a similar rule can be inferred from Art. 48, CISG.

stipulated that the contractor needed to reship the complete cargo for an important client by an exact and essential date).

B. Product withdrawal and product recall

75. Producers may be involved in the identification of dangerous and unsafe products, or in the management of the risks caused by unsafe products, and the contract or the applicable law may require them to withdraw or recall their product from the market. Withdrawals concern products that have not yet reached the market. Recalls relate to products that have reached the market and are found to be unsafe. Risk assessment and management of unsafe products may occur at different stages of contractual performance. Generally, four stages can be distinguished: (a) before delivery; (b) at time of delivery; (c) after delivery but before the contract expires; and (d) after the contract has expired. At each stage, withdrawal or recall may become necessary. The decision may be taken jointly by contractor and producer or unilaterally by the latter. If product withdrawal or recall occurs after the agricultural production contract has expired, it may be necessary for producers and contractors to cooperate with other supply chain participants to take dangerous products off the market.

76. Producers might be involved in the recall procedure, generally not as primary actors but as co-participants if the procedure includes traceability inquiries regarding the production stage. Product recalls can affect agricultural production contracts in several different ways, triggering the use of *ad hoc* remedies:

- The recall procedure may concern a component used in the agricultural chain (*e.g.* unsafe seeds). In such a case, the contractor may have reserved the right to request the producer to destroy (a) seeds purchased but not yet used or (b) products grown after the planting of the seeds;
- The recall procedure may concern products from an ongoing production chain. Not only products available for consumers need to be recalled, but also products already produced but not yet delivered to the contractor (withdrawal). In this case withdrawal and recalls may be associated;
- The producer may be required to withdraw product from a sub-supplier whenever it has handed over the product for process-

related reasons (*e.g.* the product is under drying process at a sub-supplier's premise).

77. Product withdrawal and recall may be voluntarily undertaken by the producer or required by public authorities. Agricultural production contracts may deal with withdrawal and recall in both instances. When they are voluntary, they may be the result of an independent decision by the producer or a remedy for breach sought by the contractor within a product recall procedure. The contractor may seek product withdrawal and recall within the menu of remedies for product non-conformity explicitly provided for in the contract. However, withdrawal and recall generally do not presuppose liability but simply the proof that the product may be unsafe. These are typically cooperative remedies that may require the intervention of many parties to achieve the final result.

78. When the hazard is detected at a later stage of production because its cause becomes known after the product has left the producer's sphere of control, the contract or the applicable law may oblige the producer to cooperate in the withdrawal or recall procedure. Product withdrawal and recall may concern a component or an ingredient (the tomato), the goods produced by producer (the canned tomato), or the final product at the end of the production process (the tomato sauce). Contract practise suggests that producers and their suppliers assume an obligation to cooperate with processors and distributors in actions aimed at withdrawal and recall of hazardous products. Intended beneficiaries of these obligations go beyond the contractor and include relevant participants in the supply chains.

C. Withholding performance

79. In most agricultural production contracts, payment of the price will follow delivery of the goods and inspection (see Chapter 3 at para. 124). This structure makes withholding payment a natural remedy against the producer's failure to deliver completely (at the right time and place with the right quantity) or to deliver conforming goods. In the case of non-conforming goods (or delivery at the wrong time or place), a common course of action is not to take delivery (that is, to reject the goods). Not taking delivery and withholding payment are linked and mutually reinforcing remedies. Indeed, once the contractor accepts the goods and takes delivery, payment can no longer be withheld.

80. When advance payments are provided for, withholding them may help to induce the producer to comply with several obligations along the

production line (including process-related obligations), whereas withholding payment of the balance may provide adequate incentive for a timely and conforming delivery at the end of the process.

81. More critical in practise may be the contractor's withholding of other types of performance, such as delivery of physical inputs (*e.g.* seeds or equipment), or immaterial ones (*e.g.* technical assistance) (see Chapter 3 at paras. 78-94). Indeed, the use of this remedy could undermine the production process and the attainment of the common goals pursued by the parties. However, especially when the interdependence between input provision and the production process is high, and investments are costly and relationship-specific, the contractor may prefer withholding input provision (*e.g.* technical assistance or provision of specialty seeds) to prevent sunk costs and limit the consequences of the producer's breach (*e.g.* when the producer has failed to comply with specific land maintenance standards before seed plantation). Because the parties' obligations are interlinked (see Chapter 3 at para. 3), withholding performance may be claimed as being the original breach by the other party. Accordingly, establishing a clear schedule for each party's performance under the contract may be recommended.

D. Price reduction

82. Depending on the applicable law, price reduction may normally be sought for either non-conformity or partial delivery.²⁷ Both in the case of non-conforming products and partial delivery, the applicable law may give the producer a right to perform before the contractor is entitled to reduce the price. Sometimes contractual clauses concerning partial delivery require the contractor to offer alternative options (such as a time extension, buying on the market, or reducing the price).

83. Criteria for price reduction may be contractually defined and often include a penalty dimension with an escalating adjustment of the price depending on the seriousness of the breach. They may be provided both in cases of non-conforming delivery and partial delivery. In some cases, the power to reduce the price may be contractually given to the contractor without any involvement for the producer or third parties. This procedure could be particularly advantageous to the contractor when the product non-conformity is not apparent or when the producer is not

²⁷ For international sales contracts, a similar rule is stated in arts. 50-51, CISG.

allowed to attend the product test. Nevertheless, some domestic laws and trade organisation framework contracts require or at least promote good practises by obliging or advocating the participation of the producer or trusted third parties in product assessment (see Chapter 3 at para. 138).

84. Price reduction for product non-conformity can be combined with product downgrading and damages. In such a case, damages would not cover the loss in the goods' value (which is already reflected in the price reduction) but, depending on applicable law, they could cover the lost profits that the contractor would have earned from a subsequent sale (*e.g.* when the contractor had a commitment to sell certified food products to a retailer and is unable to do so because of the producer's breach). Depending on the circumstances, these damages may also be claimed if the price is reduced for a partial delivery when the contractor is unable to meet the volume required by its client due to the producer's breach.

E. Termination

85. Depending on the applicable law, termination may generally be conditional upon fundamental breach. It could be available to the contractor in response to the producer's breach of process-related obligations, non-conformity and failure to deliver. Depending on the type of obligation, the amount of specific investments made by either party before the time in which the contract may be terminated, and the possibility for the aggrieved party to find adequate alternative options in the market (also known as exit options), termination may represent a threat to induce compliance and discourage parties from breaching the contract. For example, within a long-term relationship in which the producer has made significant investments (*e.g.* running a farm for livestock production) and the contractor is among the few able to procure the entire production, this producer will likely make all efforts to comply with the imposed standards so as not to "lose the contract." The same could apply to the contractor, for instance, if the producer has achieved a unique production capacity owing to the contractor's technical assistance and investments made in new production technologies. In the following paragraphs, termination is examined in relation to different types of producers' obligations.

1. Breach of process-related obligations

86. The parties may agree in advance what constitutes a breach, be it process-related or otherwise. Remedies for breach of process-related obligations are typically aimed at ensuring performance rather than ending the relationship. Therefore, termination for breach of process-related obligations is in practise unusual, but parties can incorporate provisions regulating the remedy especially when the breach may cause cancellation of the certification contract.

2. Product non-conformity

87. Delivery of non-conforming goods (see Chapter 3 at paras. 135-143) may result in a fundamental breach when the product does not fit with the ordinary purpose and may not be used for other purposes by the contractor. When that is the case, depending on applicable law, the contractor may seek termination, which can be combined with damages and restitution. Termination, where permitted by law in cases of fundamental breach, may be sought immediately upon rejection or after corrective remedies have failed to remedy the non-conformity. Contractual clauses often place termination at the end of a sequence, after other remedies have been tried and failed. To avoid the opportunistic use of termination threats, it is advisable that parties set forth in the contract when termination is permitted. Moving from this perspective, parties could design the sequence of remedies in order to preserve incentives to maintain the relationship and leave termination as a last resort.

3. Failure to deliver the product

88. When the applicable law links termination to instances of a fundamental breach, mere partial delivery could fail to meet this standard. Pursuant to rules generally applied to international sales, the contractor, for instance, would be able to terminate the whole contract only if the failure to make a complete delivery amounts to a fundamental breach.²⁸ The same principle could be applied to delayed deliveries or deliveries at the wrong place, where refusing performance could be unreasonable, unless the parties attached specific relevance to delivery

²⁸ For international sales contracts, a similar rule is stated in Art. 51(2), CISG.

timing due to the impact any delay would have on the contractor's economic activity, or included an express contractual clause defining delayed delivery as a fundamental breach. Depending on applicable law, damages could be claimed by the contractor.

89. By contrast, total and definitive lack of delivery (especially if accompanied by side-selling by the producer) is more likely to be qualified by the applicable law as a fundamental breach. Contracts may provide for specific remedies concerning side-selling of inputs or final products. Side-selling is usually (although not always) considered a fundamental breach and is associated with termination (see Chapter 3 at paras. 28-29). Due to contractors' concern about side-selling, penalty clauses are often coupled with termination for this type of breach.

F. Damages

90. Damages are determined by applicable law unless the parties define their own criteria in compliance with contract law principles. Contractual clauses on damages for producer's breach are not common in agricultural production contracts and they are often combined with the remedy of termination. They tend to be defined in general terms and without specific criteria to calculate them. References to such criteria may be found in Agricultural Commodity Exchange regulations. Damages may be established as a fixed amount, similar to a liquidated damage clause. Sometimes they are in the form of a down payment or deposit to be paid by the producer at the signing of the contract; in other contracts they are paid through compensation between damages and price (or any other sum due to the producer).

1. Breach of process-related obligations

91. Remedies in kind are particularly important regarding producer's process-related obligations (see Chapter 3 at paras. 105-117), but damages can play a complementary role. For example, in the case of non-compliance with safety testing standards applied to crops, correction could be attained by requesting a later screening on the product so that safety can be ensured. The loss in the goods' value is avoided by the corrective remedy and no damages can be claimed. However, if the later screening can only reduce the risk of hazards to a level which enables product sale but not in certain markets or for certain users, then damages can complement corrective actions to cover the loss in market value. Moreover, if corrective measures generate costs for the contractor, these

costs could be claimed as incidental damages from the producer in breach.

92. Breach of process-related obligations can result in a non-conforming product having a lower market value than expected. In such cases, an adjudicator assessing damages would likely award compensation to cover such loss in value. Even when a process-related breach does not affect product conformity (*e.g.* breach of social standards), the contractor might be entitled under the contract or otherwise applicable law to claim losses for damage to reputation (*e.g.* substantiated by lost profits in subsequent transactions) in light of a company's full compliance policy on process standards. In these circumstances, however, the claim could be subject to challenge by the producer because the link between the breach and reputation loss is often uncertain.²⁹

2. Product non-conformity

93. Damages for product non-conformity (see Chapter 3 at paras. 42-61) may be sought as a stand-alone remedy or in combination with other remedies. Whenever the residual value is different from zero (*e.g.* there is a market in which non-conforming goods may be sold, or the contractor has another use for them, such as feeding animals), damages may play a similar role to price reduction and may not be coupled with it. If the residual value is very low, the contractor might be interested in being released from the obligation to pay the price and prefer to seek termination. In these circumstances, the contractor may also opt for a cover purchase without seeking termination. Depending on applicable law, the contractor might be entitled to claim the difference between the contract price and the cover price (if higher). Alternatively, in some jurisdictions, market price might be determinative, regardless of the cover transaction price. In the specific context of agricultural production contracts, depending on the applicable law, market price could take into account specific features of the contractual relationship, including its domestic or international dimension.

94. Damages in combination with other remedies differ depending on whether the contractor seeks remedies in kind (such as corrective

²⁹ For international commercial contracts, a similar rule can be inferred from Art. 7.4.3, UPICC.

measures, repair or replacement), or seeks contract termination. If corrective measures or repair have been undertaken but the goods delivered still fail to meet the quality and safety standards required by the contract, the contractor may be entitled to damages covering the loss in value (see above at 87). The recovery of losses in resale volume and profits may also be claimed. However, legal systems differ as to the possibility and criteria for quantifying these losses. If the contractor has not asked for correction, repair or replacement of defective goods but has sought termination and concluded a substitute transaction, then damages are usually assessed with regard to the “cover purchase” of conforming goods. Indeed, depending on applicable law, the contractor is normally entitled to the difference between the agricultural production contract price and the cover contract price (if higher). This form of assessing damages is commonly used in the food market. The contractor may make cover purchases in a secondary market or within pending relations with other producers. Indeed, contractors often establish similar contractual relationships with several producers for identical products. In other cases, the contractor signs the agricultural production contract with a group of producers or a cooperative and the single breach is “covered” by a substitute sale by other group participants.

95. Applicable law may require that a “cover” transaction take place in a reasonable manner and without unreasonable delay.³⁰ If the cover contract price is higher only because of an unreasonable or even intentional delay by the contractor, this may not serve as a reference to assess damages. In these circumstances, courts could look at current market prices, if obtainable. The rule would be the same as that applied when no cover transaction takes place.

96. When the contractor does not engage in a substitute transaction, if international sales rules are applicable, the contractor may recover the loss sustained for product non-conformity based on the difference between the contract and the market price (*e.g.* the goods’ market value at the place of delivery). A contractor, moreover, may prefer not to disclose the cover transaction’s existence and value. For example, it might opt not to disclose its substitute suppliers. In these circumstances, contractors might prefer reference to market price, even if occasionally leading to under-compensation. Reference to market prices (sometimes

30 For international sales contracts, a similar rule is stated in Art. 75, CISG.

combined with the option for cover transactions) is quite common within Agricultural Commodity Exchange regulations.

97. By contrast, there may be cases in which reference to market prices is of little help, such as where the production is rather specific and there are no secondary or tertiary markets. This aspect may represent a further incentive for the parties to agree on contractual penalty clauses (see below at paras. 100-104).

98. In addition to the measures just described, the contractor may have the right to claim incidental damages (*e.g.* those linked with the expenses incurred to preserve the non-conforming goods until destruction or restitution to the producer). Depending on the applicable law, there can be agreement on whether the contractor may also recover consequential damages consisting of lost profits expected from the goods' resale on the market. In some cases, parties can agree to exclude the recovery of consequential damages.

3. Failure to deliver the product

99. Damages for failure to deliver (see Chapter 3 at paras. 124-143) may follow a different path if the contractor asks for (and obtains) specific performance. When delivery is late, damages will normally only cover the delay, including possible lost profits linked with better resale opportunities at the time delivery was due. The same rule generally applies when timely delivery is only partial (*e.g.* the rest of the goods are delivered later), or when the timely delivery is done at the wrong place and goods are later transported to the right place. When the contract is terminated and the contractor is released from its payment obligation, the contractor may normally recover the difference between the contract price and the goods' market price at the time of termination (if ever higher). The situation is then rather similar to the one examined with respect to termination for product non-conformity (see above at paras. 85-87).

G. Penalties, fines and blacklists

100. Domestic legal systems differ on the admissibility of fines and penalties in contract law. Because of their sanctioning function, penalties should be distinguished from liquidated damages clauses (see above para. 37). Without any necessary correlation with occurred damages, often, penalties are defined as a sum to be paid by the party in default

(monetary penalty), either a fixed amount or a percentage of the total production value, or sometimes as a percentage to be deducted from the final price. In the latter case, the penalty clause provides for a special price reduction rule, as discussed above (see paras. 82-84). Penalties can also have non-monetary content when they negatively affect reputation of the party in breach.

101. When admitted by law, monetary penalties may be provided for process-related breaches, product non-conformity, failure to deliver, or a mix of those. Having special regard for breaches of process-related obligations, penalties are meant to induce the producer to comply with requirements when non-compliance may increase the risk of more serious consequences stemming from the breach (*e.g.* failure to keep the facilities in proper condition or failure to follow proper agricultural practises that may undermine product quality). In other cases, contracts may provide for non-monetary sanctions (*e.g.* clauses prohibiting the producer in breach from concluding new contracts with the contractor). These sanctions are normally linked with particularly serious forms of breach. They often follow a “grace period” in which the producer has the opportunity to cure its breach and sometimes the contractor retains discretion on the length of the ban against contract renewal. Contractual bans against contract renewal may be seen as devices to keep control over producers’ access to a given supply chain, particularly when contractors aim to restrict access to producers capable of complying with given production standards. This practise shows how contractual remedies may have an impact well beyond a bilateral contractual relationship.

102. Penalties can have non-monetary content. In some cases, aggrieved contractors may choose to “blacklist” producers in breach, making information on the breach available for the relevant market. In this case, access to market as a whole, rather than to a given supply chain, is at stake. Due to the significant impact on the producer’s activity, this mechanism often proves to be a very effective deterrent.

H. Contractor’s conduct and claims for remedies

103. The contractor’s negligent conduct in the case of producer’s breach may affect both the availability and content of remedies. Depending on the applicable law, the power to give instructions may impose on the contractor a duty to cooperate in order to solve common problems and avert negative consequences stemming from the producer’s breach (see

Chapter 3 at paras. 118-123). Depending on applicable law, it may exclude some remedies or it may reduce the amount of damages available, taking into account the time of breach and its consequences. The contractor's typical role of providing guidance and instructions to the producer throughout the life of an agricultural production contract (see the Introduction at paras. 38-39) may influence remedies selection when problems arise at the time of input provision or later when inputs are deployed for production.

104. The contractor may be obliged to cooperate with the producer not only during the production stage, but also at the time of delivery when conformity is normally assessed (see Chapter 3 at para. 125). For example, if international sales rules are applicable, the contractor's failure to inspect the goods and give notice in a timely manner of any non-conformity may deprive it of resort to any remedy (including remedies in kind, price reduction, and damages).³¹ Further, if the contractor has a reasonable excuse for its failure to provide the required notice, then the contractor may reduce the price and claim damages, except for loss of profits, but the contractor may not resort to remedies in kind (such as repair and goods substitution).³² The contractor may be required to collaborate with the producer even after the contract has expired in product recall procedures or other traceability-related obligations.

105. Depending on the applicable law, the contractor may be requested to cooperate with the producer during the production process to ensure final product conformity. The contractor's duty to cooperate with the producer is particularly important when inputs are directly provided by the contractor or by a third party that acts under the contractor's control (for example, the contractor might have negligently chosen the input provider) (see Chapter 3 at paras. 64-72). Delivery of non-conforming inputs may prevent the contractor from seeking remedies like termination or substitute transactions under the applicable law. The contractor's duty to cooperate, when applicable, becomes even more important when the producer's defective performance materialises and the parties have to find a cooperative solution to solve the problem. Depending on applicable law, failure to cooperate may preclude the contractor from seeking termination or remedies that would otherwise be available.

31 For international sales contracts, a similar rule is stated in arts. 38 & 39(1), CISG.

32 For international sales contracts, a similar rule is stated in Art. 44, CISG.

Failure to provide instructions or the providing instructions that contribute to product non-conformity may reduce the damages to which the contractor is entitled.³³As seen in other parts of this Chapter (see above at paras. 41-43), several but not all legal systems impose on the aggrieved contractor a duty to mitigate the consequences of the producer's breach. When a duty to mitigate is not recognised, some forms of cooperation by the aggrieved party may be based on general principles of contract law like a duty to cooperate or good faith. When recognised, mitigation can result in the adoption of corrective measures by the contractor or by a third party at the producer's expense.

106. Mitigation is often aimed at solving problems related to breaches of process-related obligations that might undermine product conformity at the end of the production process. The contractor may be required to intervene directly or with the help of a third party to fix failures in the safety or quality management program so that final product certification will not be endangered (see Chapter 3 at paras. 60-61). The contractor may also intervene for defective inputs provided by the producer or by a contractually-linked third party (see Chapter 3 at paras. 71-72). In most cases, the contractor would fulfil its duty by making reasonable efforts to mitigate the effects of the breach. However, safety concerns, third parties, and the need to comply with public regulations may require a greater contractor commitment in relation to mitigation of safety hazards generated or not prevented because of the breach. It is recommended that parties specify in their contracts both the content and scope of such cooperation by the contractor, as well as contributions by third parties.

107. When non-conforming products are delivered, the content of the duty to mitigate may depend on the nature of the non-conformity. When non-conformity is related to safety, the contractor may be required to take reasonable steps to reduce or eliminate hazards related to the non-conformity, and the contractor may be asked to cooperate in fixing the causes of non-conformity. However, when product non-conformity cannot be cured, mitigation may require cooperation for replacement or substitute transactions. Acceptance of non-conforming goods may be made conditional upon reimbursement of costs incurred for mitigation (*e.g.* by deducting them from the final price).

33 For international commercial contracts, a similar rule is stated in Art. 7.4.7, UPICC.

108. Mitigation can also concern quality problems. In this instance, it can require the use of secondary or tertiary markets for products that do not meet quality expectations but can still be sold. The standard of reasonableness regarding mitigation may take into account whether the producer's breach has been partially caused by the contractor's delivery of non-conforming inputs. Differences between mitigation for safety-related breaches and quality-related breaches may also be contractually defined by the parties.

III. Producer's remedies for contractor's breach

109. Much like a contractor's remedies, a producer's remedies for a contractor's breach can serve two main purposes: as means for correcting or adjusting the effects resulting from the contractor's breach to permit accomplishment of the contractual plan ("cooperative remedies"); or as a means to compensate the aggrieved party or to remove the effects stemming from the breach ("compensatory remedies"). The role of "cooperative" remedies is particularly relevant for breaches concerning non-monetary obligations and, in any case, highly interdependent obligations (including monetary obligations). Cooperative remedies are particularly important as a means of ensuring regulatory compliance. Moreover, long-term contracts with a high level of specific investments related to participation in quality and safety management programs require a significant cooperation, particularly in cases of non-compliance where problems have to be solved jointly.

A. *Right to performance*

1. *Delay in price payment*

110. The right to price payment (see Chapter 3 at paras. 144-163) is not subject to the restrictions of specific performance of non-monetary obligations, in terms of feasibility or remedy in kind enforcement costs.³⁴ A formal request for payment will normally suffice to enforce the producer's right to an unpaid price. Depending on applicable law, the formal request could be made on a private basis, through a court, an arbitration procedure or another alternative dispute resolution

³⁴ For international commercial contracts, a similar rule is stated in arts. 7.2.1 & 7.2.2, UPICC.

mechanism. If the claim remains without satisfaction, depending on the circumstances and the applicable law, the producer might opt to enforce the judgement or award and try seizing the contractor's goods.

111. An alternative (or complementary) option could be to resort to guarantee mechanisms. The law may provide further protection for this right in contracts in which the contractor retains title to the agricultural products (for example, livestock). The law may assign the producer a first priority lien over the goods owned by the contractor (milk, crops, livestock, etc.) or on the revenues derived from their sale to third parties, if the contractor has already sold them. Issuance of a letter of credit by a bank in the producer's favour and in the contractor's interest is another means for protecting the producer's right to payment. However, bank guarantees can be expensive and are not common in this context.

2. Failure to provide (conforming) inputs

112. When the contractor undertakes the obligation to deliver inputs (see Chapter 3 at paras. 63-72), breach may concern failure to deliver or delivery of non-conforming inputs. Three situations should be distinguished depending on the time of contractor's breach concerning input provision and its detection.

113. The first situation relates to detection of non-conformity at the time of input delivery. The producer may be in the best position (and is normally required by the contract) to inspect the inputs and promptly provide notice of non-conformity. If the breach consists of incompleteness of delivery, late delivery or lack of delivery and this has an impact on the production process, the producer may have a duty to give prompt notice to the contractor. This notice may also come with a request for instructions to the contractor about measures to adopt in order to mitigate the consequences of the breach. Depending on the real possibility of obtaining equivalent inputs in the market, the producer may insist on specific performance or replacement by the contractor, or opt for a cover transaction with a third party. Some contracts expressly request the producer to take steps for such alternative transactions.

114. The second situation relates to cases of input non-conformity that can only be discovered after input delivery, but before output delivery by the producer. The inadequacy of a seed, the harmful nature of a fertilizer, and the unsafe character of feed, for example, may only become apparent after delivery during the production process. When this is the case, providing prompt notice, requesting instructions and eventually

taking proper actions could correct the production process affected by defective inputs. In agricultural production contracts for livestock, where animals are delivered to the producer, usually the contractor retains ownership throughout the contract's duration. If so, depending on the applicable law and circumstances, the producer has possession of the livestock as custodian or caretaker, or is considered a "faithful depository," being responsible for the animals' care. For this reason, several livestock contracts require the producer to inform immediately the contractor "should there be any deviation from acceptable standards." Moreover, where the livestock's mortality rate exceeds the rate established in the contract, the producer would usually immediately summon the contractor and present the carcass for inspection within an agreed short delay (e.g. within 24 hours to allow for prompt inspection by the contractor). In the case of exceeding mortality rate limits, the dead animals' value may be deducted from the producer's next payment.

115. Lastly, it may be the case that the contractor's breach concerning input provision only emerges after completion of the production process, when the producer delivers the final product and the contractor or its agents inspect it for conformity. Correcting input non-conformity at such a late stage may be more difficult. Because it is likely that input non-conformity will translate into output non-conformity, the main question is coordination of remedies available to the producer for the contractor's breach with those available to the contractor for the producer's breach. Whatever balance is found, it is important while choosing the remedy to preserve the investments and the long-term relationship.

116. Within the various remedies provided by law, the producer may have an interest in seeking remedies in kind (such as repair and replacement) when there is a strong interdependence between input and output provision and markets are thin. When inputs are easily replaceable and there is no such interdependence, however, the producer may instead prefer a substitute transaction combined with damages.

117. Inputs may be provided by a third party based on a linked contract concluded with the contractor (see Chapter 3 at para. 72). The input provider delivers the input to the producer (intended beneficiary) based on an agreement with the contractor (promisee). The third party may be a private enterprise, a non-governmental organisation, or a public institution, including Governments. The contractor may then resell the inputs to the producer, or the producer may qualify as a "third-party

beneficiary” of the contract between the contractor and the third party. The conditions upon which the producer may qualify as a “third-party beneficiary” and the rights and remedies the producer may have in that capacity will vary depending on applicable law, and may include a right to performance enforceable directly against the input provider.

118. Regardless of any rights that the producer may have as a “third-party beneficiary,” the contractor will be able to monitor the input provider’s performance, to provide instructions, and to use contractual remedies to prevent or address a breach concerning input provision. Remedies against the input provider include specific performance, repair and replacement, or corrective action. The contractor’s use of these remedies may contribute to the producer’s performance, whereas the contractor’s failure to use them when necessary may, depending on applicable law, excuse the producer’s breach. An open issue is whether the producer, besides the contractor, may seek indemnification from the third party for costs incurred because of its breach.

119. A different situation arises where the contractor, producer and input provider have signed a multi-party contract. In these circumstances, depending on applicable law, both the contractor and the producer are normally allowed to request specific performance from the input provider.

3. Failure to take delivery of conforming goods

120. Specific performance of the duty to take delivery is particularly important in cases in which commodities are subject to rapid deterioration (*e.g.* highly perishable crops), a high risk of contamination (*e.g.* particular livestock), or costs of storage (*e.g.* forestry) (see Chapter 3 at para. 135).

121. Where failure to take delivery constitutes a breach by the contractor and not a measure against the producer’s breach (*e.g.* in case of non-conforming goods), the producer normally has the right to demand that the contractor take delivery of the goods, unless taking delivery is impossible or unreasonably burdensome.³⁵ This result may be achieved, for instance, by storing the goods at an independent third-party

³⁵ For international commercial contracts, a similar rule is stated in Art. 7.2.2, UPICC and, for international sales contracts, can be inferred from Art. 62, CISG.

warehouse in the presence of a public authority on the account and cost of the contractor.

122. When preservation costs are significant or the goods can deteriorate quickly, the applicable law may require the producer to take reasonable measures to sell the goods, retaining (part of) the proceeds to cover the expenses incurred to preserve and sell them.³⁶ Some laws assign the producer the right to retain an amount equal to the unpaid price and damages. The producer's ability to resell the goods when appropriate might influence the liquidation of damages (see below on duty to mitigate at paras. 147-150).

B. Withholding performance

123. The producer may also try to induce the contractor's spontaneous performance by withholding its own performance. The effectiveness of withholding performance for inducing the contractor's compliance depends on the circumstances and the type of withheld performance. Depending on the role that the producer's performance plays in organising the production activity (for instance, making investments instrumental to production), the producer's withholding might represent a very effective threat. In the case of the contractor's failure to provide conforming inputs, for example, the impact of the producer's withholding production would be much higher than withholding payment for inputs because the interdependence between input provision and processing is much stronger than that between input provision and payment for input price.

124. In practise, the impact of withholding performance, however, may be limited. The producer may have no economic power to threaten use of such a remedy or might refrain from withholding production and investments thereof as a reaction to contractor's breach because it would be inconsistent with the production schedule. Parties may also agree to limit the producer's power to withhold performance in case of contractor's breach. In this case, depending on the contract and applicable law, there could be limitations on the producer's right to withhold production, having regard, in particular, to the following circumstances: (a) whether non-conforming inputs will result in non-conforming outputs; (b) whether production is strongly dependent on a

³⁶ For international sales contracts, a similar rule is stated in Art. 88(2), CISG.

specific type of inputs from the contractor; or (c) whether the producer is not in a position to reasonably obtain substitute inputs or take other reasonable steps to reduce the consequences of any non-conformity. In any case, cooperation requires sharing of information with the contractor in order to stimulate corrective measures from the party in the best position to adopt them.

125. Once production is completed, the producer's withholding of delivery could represent an effective tool, taking into account the consequences of a delayed delivery in terms of product deterioration and preservation costs. Moreover, if, as is often the case, the contractor's main performance (price payment) is due well after the producer's, legal principles concerning anticipatory breach (if recognised under applicable law) would limit the use of withholding performance only to cases of (anticipatory) fundamental breach.³⁷

126. Advance contractual payments for financing or co-financing production may represent a special case (see Chapter 3 at paras. 87-91). If the producer has no alternative funding sources or it is unreasonably costly for the producer to access alternative finance, withholding production may represent a useful remedy against the contractor's delay in financing production. The contract could permit the producer to withhold performance when strictly dependent upon expected finance without hindering (to the extent possible) the accomplishment of the production plan (*e.g.* the producer could be allowed to refrain from making the planned special investments while persisting in the ordinary production activity).

C. Termination

127. When the law restricts termination to cases of fundamental breach (see above at para. 24), the parties may specify the type of breach which enables use of this severe remedy. In agricultural production contracts, the selection of breaches allowing termination will normally depend on: (a) the role of compliance with particular standards for the achievement of the production plan and its possible certification, where required on completion (*e.g.* this might refer to standards applicable to inputs provided by the contractor); (b) the anticipated consequences of the

³⁷ For international commercial contracts, a similar rule is stated in Art. 7.3.4, UPICC and, for international sales contracts, in Art. 71, CISG.

breach and the possibility to correct or reduce them (*e.g.* the possibility to obtain alternative finance if the contractor fails to provide it); and (c) the extent to which the contractor departs from the requested behaviour (*e.g.* the extent of the delay in payment or the level of non-conformity of the contractor's inputs).

128. In some cases, the producer's right to terminate the contract for the contractor's breach is addressed by a comprehensive termination clause covering all parties' breaches under the contract. In other agricultural production contracts, termination clauses concerning the contractor's breach are distinguished from such clauses concerning the producer's breach. The relevance of termination mostly depends on the type of breach enabling the remedy. The following subsections consider termination by the producer as linked with various contractor obligations and breaches.

1. Failure to pay

129. When termination is by law conditional upon fundamental breach, whether failure to pay constitutes a fundamental breach mainly depends on the time at which payment is due and the length of the delay .

130. From the producer's perspective, the timing may also affect the function and desirability of termination. If total payment is due before or during production (see Chapter 3 at paras. 159-163) and the breach becomes fundamental before (all of) the producer's investments are made, then contract termination could allow the producer to avoid investments when they are difficult to redeploy in alternative transactions or to minimise sunk costs. If payment, however, is due after production but before delivery and the breach becomes fundamental when the products can be used for alternative transactions on the market, contract termination would allow the producer to seek those alternative options but not it would not prevent investments. Lastly, if price payment is due after delivery, as is often the case, the producer would normally have no interest in seeking termination, having no pending obligations from which it could be released. Instead, the producer might prefer to seek price payment, interest, and other possible damages before or in place of termination (see below at 135-140).

131. An anticipatory breach creates a slightly different situation. Even when payment is not due during production, concrete circumstances may suggest that the contractor is not likely to pay the price (or a substantial part of it), either because it has so declared or, for instance,

has become insolvent without providing adequate assurance of future payment.³⁸ If assurance is not provided within a reasonable time, also considering the goods' status (whether perishable or not), the producer may seek termination in order to be released from contractual obligations and either suspend or otherwise modify the production process or continue it and sell the goods on the market.

132. In instalment contracts and, more generally, long-term contracts covering several harvests, seasons or life cycles of the agricultural products, including livestock, the applicable law may provide that termination is available only if the breach concerning a single instalment generates a reasonable belief that a fundamental breach related to future instalments will occur.³⁹ This might happen, for example, if the contractor undergoes significant financial distress, eventually heading to bankruptcy. The exceptional nature of termination is here consistent with the nature of the contract and the intensity of cooperation envisaged by the parties, whereas a wider space for termination might induce opportunistic behaviour (*e.g.* the repudiated contractor might try to put all of the costs of investments and inputs on the producer).

133. Where engaging in production depends on advance payments (*e.g.* due to the contractor's request for specific investments financed by the contractor) (see Chapter 3 at paras. 87-91), a delay in payment may severely hinder the producer's ability to implement the contract, putting the whole transaction at risk. If the producer has alternative financing sources, applicable law may create a duty to use them while giving the producer a claim for incidental damages for the costs incurred. When no alternative financing sources are available, the producer may wish to renegotiate the original agreement, which may be a remedy preferable to termination if the parties want to preserve the relationship. For example, if lack of financing prevents certain investments for a new sustainability certification from occurring, the producer could have a legitimate interest in being allowed to convert its production into a non-certified production and indemnified for the losses incurred. When all cooperative measures fail, termination may be the remedy of last resort.

38 For international commercial contracts, a similar rule is stated in Art. 7.3.4, UPICC and, for international sales contracts, in Art. 71, CISG.

39 For international sales contracts, a similar rule is stated in Art. 73(2), CISG.

2. Failure to provide (conforming) inputs

134. Termination is relatively rare in cases of breach for failure to provide conforming inputs. The parties' mutual interest in preserving the contract would, in most cases, give priority to corrective remedies over termination, which is usually deployed when the provision of conforming input becomes impossible.

3. Failure to take delivery of conforming goods

135. In the case of a contractor's failure to take delivery, termination may play an important role because it releases the producer from the duty to deliver (see Chapter 3 at paras. 124-143), thereby enabling reselling of the goods on the market. When the law makes termination conditional upon fundamental breach, there must be either an express refusal of performance (amounting to intentional breach) or a significant delay in taking delivery with regard to the risk of the goods' rapid deterioration and preservation costs (see above at paras. 23-27). Very likely, the producer will assess the opportunity to terminate the contract, taking into account the existence of secondary markets and the possibility of accessing them in due time.

136. In the case of long-term contracts, when a fundamental failure to take delivery affects a single instalment (one harvest or group of animals) or the delivery of a single season in a multi-season contract, the applicable law could restrict the termination remedy to cases in which the breach is such that it generates a reasonable belief that there will be a fundamental breach in respect of future performance.⁴⁰ Alternatively, partial termination may be available, affecting only the instalment at stake and the relative payment.

4. Failure to purchase the whole production (or a percentage of it)

137. The producer's interest in terminating the contract for the contractor's failure to purchase the goods (the whole production or a fixed percentage of it) (see Chapter 3 at paras. 24-41) depends on the producer's opportunity for alternative deals in the market and the

⁴⁰ For international sales contracts, a similar rule is stated in Art. 73, CISG.

preservation of its position within the same supply chain after termination. Indeed, unless the applicable law and judicial system support effective protection in kind (with specific enforcement for both the duties to take delivery and to pay the price), the producer will aim to reduce the breach's consequences by selling the untaken product through a cover transaction, possibly claiming consequential damages with respect to lost profits if admissible. This preference may be counterbalanced by the contractor's ability to retaliate and prevent the producer from accessing the supply chain with other contracts. The incentives for seeking a better deal in an individual transaction have to be balanced with those of preserving a stable position within a global supply chain.

138. A particular situation may arise if the breach occurs at the end of a given harvest or season within a long-term contract. In this case, contract termination by the producer might have severe consequences because it deprives the producer of the possibility of supplying goods for several years and seasons. Here, withholding performance (see above at paras. 123-126) and partial termination may represent more adequate remedies. The producer, however, might prefer to seek termination of the entire contract if it can no longer reasonably expect future purchases by the contractor and the producer has alternative (or better) opportunities on the market.

D. Damages

139. Although any type of breached obligation may lead to a claim for damages when non-performance is unexcused, both the requirements and the legal consequences of a contractor's breach may differ. The following subsections will examine this question, also taking into account how termination, restitution and damages can be combined.

1. Delay in payment

140. Failure to pay the price (see Chapter 3 at paras. 159-163) gives the producer a claim for damages. Late payments can represent a breach of contract and constitute an unfair commercial practise and be sanctioned accordingly. Most legal systems provide for the accrual of interest as a standard measure for monetary payment delay, and normally parties can more specifically define interest rates and other possible sanctions. In practise, however, agricultural production contracts rarely or never include such clauses. Lengthy payment deadlines and the lack of

penalties for payment delays may be seen as abusive or unfair practises that exacerbate the producer's dependence on the contractor. Some legal systems have introduced mandatory rules for agricultural contracts concerning maximum delays, the burden of proof and sanctions (such as a more punitive approach to the calculation of interest rates). Similar rules exist in codes of conduct and best practise guides to prevent excessive delays. These rules are aimed at protecting the party with weaker bargaining power.

2. Failure to provide (conforming) inputs

141. When the contractor fails to provide conforming inputs (see Chapter 3 at paras. 63-94), the producer can claim damages. In stable and long-term cooperative relationships, damages do not play a major role. Parties aim to solve problems rather than seeking compensation. Damages as a substitute for performance for input provision will rarely be claimed unless the producer seeks inputs in the market and claims the difference between the agreed price and the price paid in the substitute transaction. Usually, damages will be combined with other remedies, including corrective measures, repair, and replacement. The objective is to put the producer in as good a position as the producer would have been in had the conforming good been delivered. Depending on the applicable law, when the breach is fundamental (*e.g.* it materially prevents the producer from performing its obligations due to lack of promised inputs by contractor), the producer can terminate and ask for damages. The general rule for the combination between termination and damages will apply (see above at paras. 94-96).

3. Failure to take delivery of conforming goods

142. The contractor's failure to take delivery (see Chapter 3 at paras. 135-143) includes several situations that differ both in terms of the choice between a request for performance and contract termination and in terms of the damages incurred. In particular, taking late delivery and taking delivery at the wrong place are normally compatible with the preservation of the contract. In these cases, the producer would be able to claim all the costs connected with storage, preservation and transportation of the goods, if needed to allow the late delivery or delivery at the right place, together with any other costs possibly linked with these operations (*e.g.* additional insurance costs). The delay in price payment, as well as the delay in taking delivery, can be compensated

concurrently through interest payments, where available (see above para. 40).

143. In addition to the abovementioned losses, the producer's damages could include further losses incidentally or consequentially incurred from the breach and, in particular, any cost arising out of the goods' preservation and resale. Apart from lost profits, the producer may be entitled to compensation for other losses (*e.g.* those resulting from the delayed payment because it has been incurred only after the substitute sale). Depending on the applicable law and contractual arrangements, these losses may represent a fair estimate of consequential damages. When the producer seeks specific performance of the contractor's duty to take delivery, recoverable damages could include all the costs incurred to preserve the goods until the late delivery. However, a specific cause of action might be needed for requesting the price and accrued interest, if payment is not affected together with the requested taking delivery. If the contractor fails to take delivery and wrongfully repudiates a long-term contract, the producer might be interested in recovering the costs incurred for specific investments (*e.g.* equipment, restructuring costs for the facility, etc.) when these are not reusable in future transactions.

144. Moreover, if the contractor refuses to take delivery based on an unsubstantiated or fraudulent claim of non-conformity of the goods (see Chapter 3 at para. 142), the contractor bears the consequences of the intentional breach. Depending on applicable law, these normally include liability for unforeseeable damages and, in case of fundamental breach, termination, if it is preferred to specific performance of the obligation to take delivery. Third parties (*e.g.* certifiers) might have contributed to the fraud, becoming liable for damages under contract law or tort law. There may also be an unintentional wrongful rejection (see Chapter 3 at para. 143), for example, as a result of a mistake by a third-party certifier, if the third party is engaged by the contractor. When the certification contract is signed directly by the producer, as is often the case, it is more critical to decide who should bear the consequences of a certifier's mistake, especially if that certifier was required or recommended by the contractor.

4. Liquidated damages and penalty clauses

145. In agricultural production contracts, liquidated damages clauses could play a role when applied to a contractor's breach. Smallholders may severely suffer from delayed payments by contractors, who may take

undue advantage of the producers' dependency. This is why some domestic laws impose fines or other penalties on contractors for unjustified late payments.

E. Producer's conduct and claims for remedies

146. In some legal systems, when the contractor's breach is not intentional, a duty to cooperate by the producer may help to preserve the relationship and the investments made. Where recognised, this duty to cooperate may affect the materialisation of a breach, its magnitude and consequences. For example, in the case of the contractor's duty to select and provide inputs (see Chapter 3 at paras. 63-94), the producer could be requested (by contract or applicable law) to provide the contractor with any relevant information about the choice and selection of inputs (*e.g.* disease of pre-existing livestock at the same premise where the contractor is to deliver new livestock). Depending on applicable law, the producer's failure to do so could reduce or exclude the contractor's liability.

147. Again, depending on applicable law, a mitigation duty may arise for the producer when the contractor breaches. The duty to mitigate is particularly relevant when the contractor fails to provide inputs, provides non-conforming inputs, fails to accept the goods, or wrongfully rejects them. Legal systems might not recognise a duty to mitigate, but they generally recognise a duty of the aggrieved party to act in a manner that minimises adverse consequences of a breach.⁴¹

148. When the contractor breaches an obligation to provide inputs, mitigation might require the producer to engage in substitute transactions and find inputs in the markets. When non-conforming inputs are delivered, the producer may be asked to adopt corrective measures to address the non-conformity, such as adapting the production process to the non-conforming inputs. Generally, when the contractor fails to accept the final product, the producer should sell perishable goods. Legal systems differ as to the qualification of resale. In some legal systems, the producer can but is not obliged to resell. In other legal systems, resale is necessary for mitigation but only when it is commercially reasonable. The substitute transaction by the producer can therefore influence the calculation of damages or can be qualified as mitigation.

⁴¹ For international commercial contracts, a similar rule can be inferred from Art. 7.4.8, UPICC and, for international sales contracts, from Art. 77, CISG.

149. When should the producer engage in a substitute transaction without asking for the payment price? Certainly, when waiting would imperil the ability to deliver, for example, in the case of perishable goods.⁴² In these circumstances, insisting on asking for the price may be inappropriate and the producer may be barred from getting full compensation of preservation costs if these could have been avoided.⁴³ Then the producer might be under a duty to take all reasonable measures to sell the goods, keeping the contractor informed about these steps.⁴⁴ Depending on the circumstances, in particular market structure (*e.g.* very concentrated demand), the producer's size and commercial capability, these reasonable steps may not enable a substitute sale to occur or may allow only a low-profit sale. The producer might need assistance in order to find access to a market for a substitute sale and some multiparty contracts provide for such collaboration with dedicated agencies. To assess the real possibility for a substitute transaction, account should also be given to possible prohibitions included in the contract that may have the producer dispose of goods, even though rejected or left untaken by the contractor. This approach is more common when production involves the use of special quality inputs or intellectual property rights held by the contractor (see Chapter 3 at paras. 95-104). By contrast, the mere fact that the agricultural goods (crops or livestock) are owned by the contractor may not impede a "self-help" sale if this is for mitigation of irreversible losses. Whenever the producer must take reasonable measures to sell the products, depending on the circumstances, the producer may be induced to withdraw the request for payment and terminate the contract. As seen above, this choice affects the assessment of damages.

150. The possibility of a substitute sale, if ever accessible for the producer, may also affect the choice of remedies and the assessment of damages in other circumstances, when costs of preservation are not unreasonable or goods are not subject to rapid deterioration. Here, provided that the contractor's breach is fundamental (*e.g.* because delay in taking delivery and payment is unreasonable), the producer may opt for termination and try to sell the produce on the secondary market. It is

42 For international sales contracts, a similar rule is stated in Art. 88, CISG.

43 For international commercial contracts, a similar rule is stated in Art. 7.4.8, UPICC and, for international sales contracts, in Art. 77, CISG.

44 For international sales contracts, a similar rule is stated in Art. 88, CISG.

highly recommended to define in the contract what constitutes reasonable mitigation in cases of contractor breach.

CHAPTER 6 – DURATION, RENEWAL AND TERMINATION

1. The issues of contract duration, termination and renewal are of great importance in the context of agricultural production contracts, because these contracts imply by their very nature the carrying out of a continuous or periodic activity for at least one of the parties. It is therefore essential for the parties to know from the outset when their contractual relationship begins and ends. Equally important are whether and, if so, how the contractual relationship may be terminated before its expiration date or renewed when it comes to an end.

2. Parties are well advised to address specifically these issues in their agreement. Indeed, domestic legislation, to the extent that it deals with duration, termination and renewal at all, is normally confined to a few basic rules, such as those imposing minimum or maximum duration periods or requiring notice in writing in the case of termination. Further details are left to be agreed upon by the parties in each given case.

3. In fixing the duration of their contract and regulating its termination and possible renewal, parties should be aware that these issues are largely interrelated. For instance, the shorter the duration of the contract, the greater the need to expressly provide in the contract for its possible renewal at the expiration date. Conversely, the longer the duration, the greater the need to provide for the right of either party to terminate the contract prematurely.

I. Duration

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

investments require that the contractual relationship between the producer and the contractor be long enough (see Chapter 2 at para. 112 and Chapter 3 at para 76).

5. Duration clauses can be drafted in various ways, such as by fixing a number of calendar days, months or years starting from a set date, or a precise period between a set date and an event or between two specified events. The parties may also make the contract duration dependent on the performance of their obligations.

A. *“Short-term” contracts versus “long-term” contracts*

6. Generally agricultural production contracts may be of short duration, usually expressed as a number of months or with reference to a crop season, or be structured as a long-term contract, either by specifying a longer period of several years or simply by not specifying an ending term.

7. The reasons for choosing one option or the other mainly depend on the nature of the agricultural products involved and the parties' willingness to be bound over a short or longer period of time. Contracts for short-term crops such as vegetables and field crops are usually concluded on an annual or seasonal basis, whereas crops such as tea, coffee, sugar cane and cocoa may require contracts of a longer duration. Livestock production and marketing contracts are normally stipulated to last for a longer period. More generally, parties will prefer a longer contract duration when they are interested in a solid and lasting relationship, particularly in view of the necessity for the producer to make long-term investments.

8. Long-term agricultural production contracts give rise by their very nature to a relationship based on trust and confidence between the parties and an ongoing duty to cooperate to allow each party to perform properly its obligations. This has significant implications with respect to, for example, the producer's right to terminate unilaterally the contract (see below paras. 32-35), the possible right of either party to terminate the contract for loss of trust (see below, paras. 36-37), and special remedies in the case of change of circumstances (see Chapter 4 at paras. 32-33).

B. Maximum and minimum duration imposed by law

9. In some legal systems, agricultural production contracts are subject to minimum duration periods, which are very often connected to the production cycle. There may also be limitations as to the maximum contract duration. Thus, domestic laws may provide that fixed-term contracts can be concluded for no more than a set number of years and that a longer period will automatically be reduced to the term prescribed by the law. When negotiating an agricultural production contract, parties will therefore have to ascertain if the applicable law provides restrictions on its duration.

10. In cases where production is to be carried out on leased land, the relation between the agricultural production contract itself and the land lease contract is another aspect that must be considered (see in this regard Chapter 3, para. 74). Domestic laws sometimes expressly address this matter, by stating for instance that the production contract cannot be stipulated for a longer period than the land lease contract or that, if the parties do not stipulate the exact duration of the land lease contract, it is presumed that its duration is a set number of years.

II. Renewal of contracts

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

A. Renewal by express agreement

12. Parties may stipulate that their contract can only be renewed by an express agreement in writing. This clause may be structured so that the parties prescribe that the agreement will last for a set period unless the parties come to an agreement to renew before the end of that period. However, if the parties renew the contract only orally or by mere conduct notwithstanding such a clause, in some jurisdictions they may

be prevented from invoking it subsequently because of the general principle prohibiting inconsistent behaviour.¹

13. While the contract will normally be renewed under the same terms as the “old” contract, the parties may occasionally provide that they will enter into negotiations within a certain period of time before the expiration date, with a view to renewing the contract and possibly revising some of its terms to take into account relevant changes (for example concerning prices), which might have occurred after the “old” contract’s conclusion. The contract may explicitly mention that the parties will act in good faith during such negotiations to enter into a new written agreement, but that if the parties fail to reach a new agreement, the agreement will expire. The contract may state that there is no obligation on either party to renew the agreement, but if both parties are satisfied with the performance of the current contract, they may provide notice to the other party a set amount of time before the contract’s expiration.

B. Tacit or automatic renewal

14. An agricultural production contract may also be renewed tacitly or automatically. This may occasionally occur even in the absence of any contractual provision to this effect, for instance when the parties continue to behave as if the contract was still in existence after the expiration date. However, in most cases the contract expressly provides that it will be tacitly or automatically renewed if neither of the parties expressly objects within a specified period of time.

15. In short-term contracts, parties frequently stipulate that the contract is to be automatically renewed for additional periods of the same or a different duration, unless one of the parties terminates it by providing a notice in writing within a certain period of time before the expiration date. Automatic renewal can be limited to a specified number of times.

16. A contract that has initially been concluded for a short period, even if renewed periodically for other equally short periods, may *de facto* create a long-term relationship lasting for many years. This course of action is particularly common for agricultural production contracts influenced by seasonal or periodical factors such as the growing cycle,

¹ For international commercial contracts, a similar rule is stated in Art. 1.8, UPICC.

harvest and production process. In this context, it may occur that even after a series of annual or periodical renewals, the contractor unilaterally terminates the contract by providing notice only a short period of time in advance. The contractor behaves on the ground that the renewed contracts, like the original contract, are also fixed-term contracts of a short duration that may be terminated on short notice. However, the continued renewal of the “old” contract over many years may have caused the producer to believe reasonably that its contractual relationship with the contractor had *de facto* become a long-term relationship. Thus, in some jurisdictions, according to the general principles of good faith and the prohibition of inconsistent behavior,² the contractor may be precluded from terminating the contract on short notice and be obliged to give notice of termination a reasonable time before the renewal date.

17. In determining the reasonableness of the notice period, courts may look to the actual duration of the relationship, the particular nature of the agricultural production involved – especially the crop’s biological and production cycle – and any substantial investments that have been undertaken by the producer.

18. To avoid any uncertainty in this regard, domestic laws sometimes limit the possibility of tacit renewal of agricultural production contracts. For example, they may permit renewal only for a maximum period of one year unless otherwise provided by the parties by written agreement, or prohibit tacit renewal altogether and provide that whenever the parties continue the contract’s execution, it will tacitly be regarded as a permanent contract with no specified term.

C. Renewal at the option of one party

19. Exceptionally the contract may provide that only one of the parties, in most cases the contractor, typically the stronger party, is entitled to extend the contract’s duration, and that when the contractor decides to do so the producer must accept the renewal unless it makes compensatory payments. Such clauses are sometimes included when the contractor provides advances or inputs to the producer; here, the parties might include a contractual provision that gives the contractor the right to

² For international commercial contracts, similar rules are stated in arts. 1.7(1) and 1.8, UPICC.

renew the agreement until the contractor has recouped its advances. However, such unilateral renewal clauses may be considered unenforceable in some legal systems on the ground that they give the contractor an excessive advantage over the other party without any justification.³ A producer that is required to make significant capital investments to perform its obligations under the contract might wish to obtain for itself a similar right (see below para. 35).

III. Termination

A. *Scope*

20. The term “termination”, or equivalent terms that may be used in contract practice, covers various situations, ranging from the automatic termination of the contract at the expiration date or upon fulfilment by the parties of all their obligations to the termination by either of the parties in the exercise of a right provided by agreement or by the law. For the purpose of this Chapter, the term “termination” is to be understood in a broad sense so as to cover virtually all cases where the contract is brought to an end, either automatically or on the initiative of either party, the exceptions being termination for breach, force majeure and changed circumstances, which are specifically addressed in Chapter 5 on Remedies for Breach and Chapter 4 on Excuses for Non-Performance, respectively.

B. *Termination clauses*

21. Several countries recommend in their domestic legislation that parties include so-called *termination clauses* in their contract, that is provisions specifying when and how the contract is to be terminated automatically or on the initiative of the parties. Indeed, the more precisely the parties regulate the possible cases of termination of their contract, the more stable and predictable their relationship will be.

³ For international commercial contracts, a similar rule is stated in Art. 3.2.7(1), UPICC.

C. Notice requirement for termination

22. When the contract is of an indefinite duration, or when termination is permitted under the contract before its expiration, a party intending to terminate the contract is often required to give notice of its intention to the other party. In order to be effective, the notice has to meet certain requirements as to form.

23. The notice in general has to be given in writing, and sometimes even in the form of a registered letter or judicial writ. As far as time is concerned, an advance notice is generally required, but how long in advance it must be given very much depends on the circumstances of the case. Possible solutions range from rather flexible time limits that take into account the production and marketing cycle or the amount of investments, to very precise time limits with a set number of days. Generally speaking, it is fair to say that the longer the contract duration, the longer the period of required advance notice, and *vice versa*. In any case, it is preferable to stipulate precise time limits.

24. The consequences for failing to observe the prescribed form or time requirements also depend on the circumstances of the case. Thus, if the notice receiver does not object on the ground that the notice was not given in the form or within the time provided in the contract, the receiver's silence may be construed as tacit consent to derogate from the respective contract provisions. Even if the receiver rejects an improper notice, the terminating party may still serve a new one in the prescribed form or accept that termination is postponed until the end of the prescribed notice period.

D. Grounds for termination

25. Termination of agricultural production contracts may occur for various grounds and in various forms. Apart from termination for breach (explained in further detail in Chapter 5), the most important grounds include: (a) automatic termination upon expiration of the established duration or performance of contractual obligations; (b) termination by mutual consent; and (c) termination by one of the parties in accordance with special termination clauses.

1. Automatic termination

26. Fixed-term contracts normally end automatically and without any advance notice on their stipulated expiration date, or after the legally prescribed maximum duration period. Yet, parties may also provide for the contract's automatic termination upon fulfilment of their contractual obligations.

2. Consensual termination

27. An agreement between the parties releasing each other from their mutual obligations is another way to end the contractual relationship. Although domestic legislation may expressly indicate this possibility for the sake of completeness, it is rather rare to see it in contractual practice because parties take for granted that they may terminate their relationship by agreement even in the absence of a specific provision to this effect in their contract.

3. Termination by one of the parties in accordance with special termination clauses

28. Most agricultural production contracts contain provisions that allow parties to terminate unilaterally the contract. When they entitle both of the parties to do so, one speaks of bilateral termination clauses, and when they provide termination by one party only, of unilateral termination clauses.

(a) Clauses providing for termination by either party

29. It is a generally recognised principle that a contract may not bind the parties eternally and that where they have failed to specify its duration, they are allowed to opt out of it provided they give notice a reasonable time in advance.⁴ Express provisions to this effect are quite normal in agricultural production contracts of indefinite duration, but may also be found in fixed-term contracts of long duration. In both cases, it is common practice that the parties indicate a precise period of time within which the advance notice must be given.

⁴ For international commercial contracts, a similar rule is stated in Art. 5.1.8, UPICC.

30. While parties are normally free to end the contract at any time, a clause sometimes provides that termination may occur only following a certain period of time after the contract's conclusion. This time period may take account of investments made by one or both of the parties.

31. In most cases, the parties are entitled to terminate the contract without any explanation, but the terminating party might occasionally be required to state the reasons for doing so. When giving reasons for termination, the terminating party might have to comply with notice requirements as to form and timing.

(b) Clauses providing for termination by one party

32. Agricultural production contracts may provide that only one of the parties, often the contractor, is entitled to terminate unilaterally the contract. Such one-sided termination clauses are typically found in contracts of an indefinite duration, but may exceptionally be contained in fixed-term contracts of a relatively short duration, thereby enabling unilateral termination before the term's expiration.

33. The unilateral right to terminate the contract may be subject to some limitations. The contractor may thus be required to give prior notice to the producer for a stipulated time. As a further protection to the producer, termination may be permitted only following a certain period of time after the contract's conclusion. In contract practice, however, the contractor is often entitled to terminate unilaterally the contract at any time, for any reason and without giving prior notice, taking advantage of a so-called "termination at will" clause.

34. Termination clauses granting only one of the parties the right to terminate the contract at will may be unenforceable under the applicable law, on the ground that they give that party an unfair advantage over the other party without such a right.⁵ Indeed, by allowing termination at any time the contractor may end the contract with immediate effect even shortly after its conclusion, thereby causing substantial loss to the producer who may no longer be in a position to absorb the costs of capital investments made in reliance on a longer contractual relationship. Moreover, by permitting the contractor to end the contract for any reason

⁵ For international commercial contracts, a similar rule is stated in Art. 3.2.7(1), UPICC.

whatsoever or no reason at all, the right of termination may be abused as mere retaliation against the producer.

35. To avoid or at least reduce such risks and possible abuses, domestic laws may provide special protection for the producer. Especially when the producer had to make capital investments of a considerable amount pursuant to the contract, the contractor may be required to give the producer notice of its intention to terminate the contract a sufficient time before the effective date of termination. Moreover, the contractor may be obliged to reimburse the producer for any damages incurred due to early termination. However, because such protective legislation is still the exception, parties are well advised to provide expressly in their contract for some restrictions on early termination by the contractor, such as the duty to give notice of its intention to terminate the contract a reasonable time in advance, and the duty to reimburse the producer at least in part for the losses suffered due to early termination.

(c) Termination for loss of trust

36. Agricultural production contracts, particularly if concluded for a longer period of time, may be subject not only to the usual risks of a breach by one of the parties or of supervening events making performance impossible or excessively more onerous, but also to the risk of a total loss of the parties' trust and confidence, making the continuation of their relationship, at least for one of the parties, no longer sustainable. In some jurisdictions, parties are granted the right to terminate the contract for this reason.

37. Parties may wish to provide in their contract for the possibility to terminate their relationship for the loss of their trust and confidence. To this effect, they may choose between two different approaches: they may either draft the general termination clause(s) in such broad language (*e.g.* "[...] at any time, for any reason or no reason at all [...]") to cover also the right to terminate the contract for loss of trust, or make a special provision for such a right. Such language could however create uncertainties and causes for opportunistic behaviour. Alternatively, they may deal with termination for loss of trust in a separate provision, drafted either in general terms or specifying the event(s) warranting termination; such listed events might include when either party becomes subject to a judicial order or bankruptcy proceedings. The latter approach would not only allow the parties to better define the contingencies in which the contract may be terminated for loss of trust but also to specify how such

a right may be exercised (*e.g.* by mere notice to the other party or only by notice in advance), when termination takes effect (*e.g.* immediately or only after a certain period of time), and whether the terminating party or the other party is entitled to damages.

E. Effects and consequences of termination

38. As a rule, the parties are released from their obligations to perform and to accept future performance upon termination, but the accrued rights or liabilities, such as the right to claim damages for non-performance, survive.⁶ Parties to an agricultural production contract may include in their contract an express provision to this effect. Moreover, termination does not affect any provision in the contract for the settlement of disputes or any other term that is to operate even after termination.⁷ Finally, when a producer has prematurely terminated the contract and has received financing from the contractor, the reimbursement obligations remain due after the end of the contract.

39. The parties may wish to specify in their contract those provisions that are to survive and to continue to bind the parties even after the contract's termination. In the context of agricultural production contracts, such post-contractual obligations may concern the return of seeds and plants, as well as documents or technical equipment that were necessary for the production process. Occasionally, so-called confidentiality or non-disclosure clauses may prevent the producer from divulging information about technologies or the production process even after the end of the contractual relationship with the contractor. Likewise, so-called non-compete clauses may prevent the producer from carrying out an activity in competition against the latter for a certain period after the end of their relationship. Under most legal systems, however, such non-compete clauses may be struck down, or limited in their application by the courts, if they contain unreasonable limitations as to the geographical area, time period and nature of the activity in which the producer may not compete.

⁶ For international commercial contracts, a similar rule is stated in Art. 7.3.5(1)-(2), UPICC.

⁷ For international commercial contracts, a similar rule is stated in Art. 7.3.5(3), UPICC.

CHAPTER 7 – DISPUTE RESOLUTION

1. This Chapter discusses dispute resolution in the context of agricultural production contracts, and then provides an overview of three kinds of dispute resolution mechanisms, namely mediation,¹ arbitration and judicial proceedings. Although its main focus is on dispute resolution in a domestic setting, it also considers the particular situation for international contracts. It should be noted that this Chapter focuses only on the resolution of contractual disputes arising directly out of an agricultural production contract within the Guide's scope.

2. In some legal systems, however, dispute resolution mechanisms may also be provided for under competition law or unfair practices law. As indicated in Chapter 1 at paras. 56-57, competition law rules may be relevant for the relationship between the producer and contractor, to the extent that the relationship may produce anticompetitive effects. Claims based on competition law are generally settled by anti-trust authorities. Such mechanisms and their enforcement will depend on the scope of application of the relevant laws. For example, certain laws entitle an aggrieved party to file an anonymous complaint in order to avoid the other party's possible retaliation (such as not renewing the contract). Furthermore, in a number of countries, a public authority holds the power to impose fines or sanctions of a civil, administrative or even, in some cases, a criminal nature. This is merely to flag this potential area, as the sections below focus on disputes between the parties arising directly out of the agricultural production contract.

¹ As it will be seen in this Chapter below at para. 20, "mediation" is hereinafter used to refer to all amicable dispute resolution methods, which may include for example conciliation, but other terms may also be found.

I. Disputes and dispute resolution in agricultural production contracts

A. *Addressing disputes in agricultural production contracts*

1. *The importance of addressing dispute resolution in the contract*

3. When entering into an agricultural production contract, the parties should envisage that disagreements may arise that they might not be able to solve on their own. Certain areas of agricultural production contracts are particularly prone to controversy: this may in particular be the case regarding the quality or quantity of the delivered inputs or the final product; the producer's compliance with production methods; the occurrence of relevant events for discharging the parties from their obligations; the application of the pricing mechanism; and the grounds for terminating the contract. In addition, many of the parties' obligations – especially of the producer – require diligence and best efforts, a standard that may be more open to argument than when an objective result is to be attained. Thus, when negotiating and drafting the contract, the parties are well advised to envisage a method for dealing with disputes that they may not be able to solve directly, thereafter requiring third party intervention.

4. The existence of effective and accessible mechanisms for dispute resolution is essential to ensure contractual justice and generally to foster contract compliance. Access to a fair dispute resolution system becomes all the more important when the parties' relative economic powers are particularly unbalanced. The contractor will typically be in a better position to make use of the remedies provided for under the contract. Conversely, the producer may not be in a position to react to the contractor's breach or unfair conduct, let alone to raise a claim, because of the costs involved, general logistical problems, or the fear of not having the contract renewed or being subject to other forms of retaliation. Advocacy and collective action supporting individual producers in their dealings with contractors thus have a very important role to play, especially in assisting producers that face unfair situations. However, contractors may also face challenges in resolving disputes with smallholders when the relatively small losses involved do not justify resorting to more costly dispute resolution procedures.

2. Preventing disputes through negotiations and cooperation

5. When problems arise, the parties should first endeavour to overcome them through negotiations and cooperation based on general principles, specific legal obligations and also, very often, the clauses in the contract itself. These aspects have been developed in Chapter 5 on Remedies for breach, where the role of cooperative remedies have been emphasised. Often, reputational implications and peer pressure may enhance compliance with the contract and may help to resolve quickly disputes at this early negotiation stage. External entities may play an important role at this stage by providing advice, technical opinions, monitoring or facilitating the relationship. In addition, the parties may design procedures to review regularly issues or to manage problems as soon as they arise.

6. The parties may also agree on several dispute resolution methods to be used on a sequential basis in order to avoid and solve conflicts. Normally, conflicts arise and grow until they become an irreconcilable dispute; but, several dispute resolution methods may enable the parties to address the conflict adequately at every stage. For instance, parties can agree to a first phase of negotiation, subsequent mediation and then, in the absence of agreement, they can resort to arbitration. These clauses may be very useful for increasing the probability of solving a conflict amicably, and they permit the parties to choose what steps to follow in the event of dispute. Parties can choose between a wide range of amicable dispute resolution mechanisms that generally fall under the concepts of mediation or conciliation (see below at paras. 20-29). This may avoid reaching a point where contract performance is suspended and the business relationship is threatened or broken. To ensure the clause's enforceability, special care should be taken in its drafting. In particular, it is important to specify the time limit for the negotiation or mediation steps.

3. Parties' access to a fair and effective dispute resolution method

7. Despite negotiation efforts, the continuation of the contract or relationship as it stands, or even with different terms, is sometimes no longer possible or desirable. The priority then shifts to settling the conflict in the best possible manner, on a fair basis and with effective enforcement. Indeed, the enforcement of rights and access to a fair trial are fundamental principles that are typically protected under civil and

human rights, constitutional laws or other sources. Clauses whereby a contracting party would waive its rights to seek redress through an appropriate dispute resolution mechanism would likely be unenforceable in most legal systems.

8. While parties can usually bring their claims before a court, so-called alternative dispute resolution – or non-judicial – procedures frequently offer more appropriate solutions in the context of agricultural production contracts. As a result, special regulations on agricultural production contracts, standard contracts, good practices and codes of conduct all invariably encourage or even require the parties to have recourse to alternative dispute resolution methods. Such methods may involve either amicable procedures, or binding arbitral proceedings leading to a final decision that will be enforceable under the law. Regardless of the method chosen, by being aware of how controversies will be settled, by whom and on what basis in a particular context, parties will increase the underlying transaction's predictability, which will in turn foster contract compliance and successful contract farming relationships.

B. Considerations regarding the various dispute resolution methods available for the parties

9. As suggested by the discussion above, there are many possible methods of resolving disputes, which may be grouped into three broad categories. First, through amicable procedures, the parties seek a mutually acceptable solution with the assistance of a third party and, if found, apply it on a voluntary basis. Second, under arbitration, the parties appoint one or more arbitrator(s), agree on the rules governing the proceedings and are bound to comply with the decision. Both amicable procedures and arbitration are non-judicial, "alternative" dispute resolution mechanisms. Third, under a judicial process, parties are subject to the authority of courts, which apply the rules of civil procedure enacted by the domestic law. The decisions rendered both under arbitration and judicial proceedings are binding and enforceable through public execution procedures. Accordingly, one of these two mechanisms for dispute resolution is typically stipulated as the choice of last resort when amicable methods have failed.

1. Nature of the dispute, time factor, interim relief

10. A number of factors may affect the application of (and the parties' ability to resort to) these dispute resolution methods. The first important factor is the nature of the dispute. Under domestic law, certain types of disputes are often precluded from private settlement. This may be the case under certain legal systems when public or governmental parties are involved, making the dispute fall under the mandatory jurisdiction of administrative courts or other public entities. This may also be the case, in some countries, when issues of public policy or third-party rights are at stake (for example in areas such as antitrust and competition, insolvency, intellectual property, employment, illegality and fraud, bribery, corruption), or some types of investments in natural resources.

11. The time factor can be very important in many disputes, favouring the use of mechanisms that are typically quicker. In many instances, prompt attention to a dispute will provide a better understanding of the issues at stake, protect the interests involved, and preserve evidence. Expedient dispute resolution may therefore avoid additional economic losses, restore the parties' trust and allow their relationship to continue. On the other hand, when the contract has already been terminated, it will be a matter of efficient justice to settle the conflict and allow the aggrieved party to obtain compensation within a reasonable time.

12. Parties should in principle be entitled to apply for interim relief when a prompt and publicly enforced action is required pending final determination of the dispute. Interim measures serve different purposes (such as preventing irreparable harm to a right, preventing destruction of goods or evidence, or ensuring enforcement of a future judgment). The procedure may vary depending on the dispute resolution method chosen – whether arbitration or a procedure with domestic courts – and the applicable law.

2. Fairness, confidentiality

13. The fairness of the dispute resolution mechanism depends on the mediators or adjudicators acting independently and impartially. The proceedings must guarantee that both parties enjoy the same opportunities to raise a claim and present their case, with particular attention to the potential imbalance deriving from one party's weaknesses. In this context, it is essential for the producer in particular to be adequately advised and represented. Depending on the applicable

dispute settlement mechanism, producer organisations, unions or associations with advocacy functions may play a very important role in assisting an individual producer to make a claim and navigate the dispute management process. Fairness also requires adequate access to a dispute resolution mechanism, which is often limited by geographical, social and economic factors. Moreover, fairness imposes certain requirements on the authority settling the dispute, including its independence from the parties, impartiality, integrity and professional skills and competence regarding dispute's subject matter, with possible nuances depending on the particular dispute settlement method. Fairness also requires taking into account all relevant technical and legal aspects of the case, directly or by having recourse to expert opinions on particular issues.

14. In addition, some methods, such as litigation, are public, while others such as mediation or arbitration may have a confidential character when so provided by the contract or the applicable legal system. This may be a relevant factor to consider because of its potential impact on the parties' broader commercial operations. Contractors, and even producers, may not want the results of a settlement or even its mere existence to affect their ability to conduct business or to enter into new contracts. Moreover, parties may want to prevent competitors from learning about the dispute's existence or content.

II. Non-judicial dispute resolution methods

A. *Common features*

15. As an alternative to court proceedings, which take place upon one party's action, recourse to non-judicial settlement methods such as mediation or conciliation mechanisms and arbitration is based on both parties' consent. To consent to these methods, the parties may either include a term in their agricultural production contract or conclude a separate agreement, usually after the dispute has arisen. Non-judicial methods may be particularly suitable for disputes arising out of agricultural production contracts because they are usually timelier and more flexible than judicial proceedings. Special regulations on agricultural production contracts typically encourage or even require the parties to have recourse to alternative dispute resolution methods and may also provide for particular rules to apply to such procedures.

16. The choice of which dispute resolution mechanism to adopt can be based on the nature of the dispute. For example, resolving objective

product quality disputes might call for rapid expert adjudication, whereas more legally-based disputes might require a different mechanism, such as arbitration. Another important factor is the outcome that is intended by the parties when choosing the dispute resolution mechanism. Alternative dispute resolution – especially mediation – could be more conducive to maintaining trust and preserving the relationship between the producer and the contractor. It may also provide for a solution to the ineffectiveness of suing small producers through normal court procedures. However, non-judicial methods may not always be less costly than judicial dispute resolution. This is in part due to the fact the parties have to pay the mediator or arbitrator fees, in addition to their own counsel's fees if they choose to be represented. Moreover, enforcement of a mediated settlement may require a party to bring a court application anyway.

17. Under alternative dispute resolution mechanisms, the parties may choose an *ad hoc* procedure whereby they appoint a third party to resolve their dispute and decide on the rules to be applied. Very often, however, the parties resort to one of the various institutional systems providing mediation or arbitration services. These institutions may be private or promoted by the government. Some trade associations offer dispute resolution services which may be based on the representation of both contractors and producers. Examples of private institutions providing dispute resolution methods may be found in many commodity specific industries, either at the international or domestic level.

18. On the other hand, private institutions providing general alternative dispute resolution services can be found in most countries, for example regarding arbitration, normally denominated as an "arbitration association." The role of such institutions generally consists of assisting the parties in organising the rules applicable to the proceedings, settlement, providing assistance in the choice of a mediator or arbitrator, and offering logistical and administrative support for managing the procedure. Each institution has regulations for the conduct of the proceedings that the parties may adopt. Institutional systems may also be public or mixed. Special institutions, boards or otherwise designated bodies having competence to mediate or arbitrate disputes on a voluntary or mandatory basis may be established by a general law on contract farming or by commodity-specific regulations.

19. It is important to note that domestic law typically deals with how proceedings are instituted, how panels can resort to court support, the

extent to which a court can set aside an arbitral award and so forth. A significant number of jurisdictions around the world have found inspiration for those laws in the work of the United Nations Commission on International Trade Law (UNCITRAL), even though this work was originally conceived for an international purpose. The *UNCITRAL Model Law on International Commercial Arbitration*² and the *UNCITRAL Model Law on International Commercial Conciliation*³ offer a possible model for the drafting of legislation intended for domestic transactions. Regarding the former, while most of the provisions contained therein would apply as default rules, certain conditions are mandatory for an arbitral award to be publicly enforceable.

B. Mediation and conciliation mechanisms

1. Alternative amicable dispute resolution methods

20. Under amicable dispute resolution, the parties seek a mutually acceptable solution with the assistance of a third person, and commit to apply it on a voluntary basis. Commonly used terms are mediation – hereinafter used to refer to all amicable dispute resolution methods – and conciliation, but other terms may also be found.⁴

21. While mediation may be related to or used in conjunction with other methods of resolving disputes, it should also be seen as a stand-alone procedure. Under the prevailing approach in a number of legal systems, mediation is clearly distinct from adjudicatory dispute resolution methods, namely arbitration and courts. Mediation is a separate process by which the mediator assists the parties in settling their dispute, but does not have the authority to impose a solution. Contrary to “negotiations,” where only the parties are involved, the mediator’s intervention aims to facilitate dialogue between the parties and assist them in their attempt to reach an amicable settlement of their dispute,

² UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006, Text and Explanatory Note, available on the website of the United Nations Commission on International Trade Law (UNCITRAL) at http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration.html

³ UNCITRAL Model Law on International Commercial Conciliation (2002), Text and Guide to enactment, available on the website of the United Nations Commission on International Trade Law (UNCITRAL) at

http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2002Model_conciliation.html

⁴ See Art. 1(3), UNCITRAL Model Law on International Commercial Conciliation.

generally in accordance with a defined structure, timeframe and rules. Mediation is usually the next step after a failure of the negotiations between the parties. In particular situations, mediation may also take place at a preliminary stage, even before the contract is concluded.

2. Benefits of mediation

22. Mediation has several benefits. Parties are free to organise the procedure according to their particular situation, with limited formality. It is generally simple to organise and trigger, allowing parties to deal with conflicts at an early stage. Furthermore, mediation generally takes place over a short period, has low cost implications and can be implemented both for small disputes and large conflicts that the parties would prefer not to bring before a court. Mediation encourages dialogue between the parties with a view toward finding a solution acceptable to all parties. The mediator gives consideration to the circumstances surrounding the dispute, including the relationship's technical, economic and social dimensions, which contributes to assisting the parties in understanding the other party's perspective.

23. As a result, mediation generally leads to relatively quick outcomes through settlement agreements, which should cover in an ideal situation all aspects of the dispute. A mediated solution may also preserve or restore the relationship between the parties, ensuring that the contract is implemented for the rest of the period. Agreements resulting from mediation are more likely to be complied with voluntarily, because resort to mediation requires both parties' consent in the first place. In any event, if mediation proves unsuccessful, the parties may then still turn to binding settlement procedures.

24. Because mediation provides a sound approach to disputes arising out of agricultural production contracts, most examples of specific legislation governing this type of contract provide for its use. This may be a mandatory obligation for the parties, who may be generally required to include an express clause to that effect in their contract. Even when not legally bound to do so, parties will always be well advised to provide for amicable dispute resolution procedures. Although such procedures may be chosen at any time, it is highly recommended that parties provide for them prior to any dispute arising, preferably in provisions of the agricultural production contract itself rather than under a separate agreement.

3. *Organising mediation proceedings*

(a) *Mediation clauses*

25. Mediation clauses may be more or less detailed in designing the proceedings, but two elements should be considered essential. The first is an express determination to submit disputes to mediation. Although a general statement reflecting the parties' willingness to solve problems or to settle amicably any dispute may encompass resort to mediation, it is preferable that clear language be used. If parties intend to be bound by the clause, they have to make clear that mediation is set up as a pre-condition to be fulfilled prior to resorting to arbitration or litigation.

26. In order to ascertain the parties' intention, domestic courts and arbitral tribunals have taken into account different elements that evidence real consent (*e.g.* whether the parties have established the place and language of the procedure or a time frame in which the mediation has to take place). If the parties fail to draft a precise clause, the latter can be considered by the court or arbitral tribunal as an agreement to agree, which is not enforceable in many legal systems. In addition, parties should also provide for a particular institution to mediate or for ways to appoint the mediator when a dispute arises, except when a mediation institution is mandatorily competent or designated under the applicable law.

(b) *Institutional versus ad hoc mediation*

27. While the legal frameworks of some countries allow parties to choose an *ad hoc* mediation procedure, others often refer on an optional or mandatory basis to one particular institution which has authority for such settlements, either for this particular category of contracts or for agricultural disputes more generally. The designated institution may be a dedicated department of the Government, or a board or entity which includes professional organisations representing the parties' interests as members and may generally be under the control or coordination of a Government authority. Institutional mediation, or mediation relying upon mediators recommended by an institution, should guarantee that the mediator is neutral and conducts the proceedings in an effective, impartial and competent way.

28. In the context of *ad hoc* mediation, the parties may choose a mediator with qualities corresponding to their particular situation, provided that the mediator has both parties' trust. Appointing a particular

person as mediator in the contract may lead to problems regarding the clause's enforceability if something happens to that specific person. Therefore, it may not be recommended to appoint a specific person as mediator in the dispute resolution clause.

29. When agricultural production contracts are concluded with producers with a strong social dimension, such as indigenous communities, special kinds of mediators may play an important role. It is also important to remember that traditional dispute resolution mechanisms might exist parallel to the official ones, for example at the village level. Respected persons who, although not necessarily neutral, are perceived as being fair, may be seen as serving the intended purpose. Described as "social network mediators," they are generally concerned with maintaining stable long-term social relations, and are able to draw on social or peer pressure to enforce agreements. From this point of view, mediation can be seen as a method for ensuring that both parties' interests are respected. Also, unless specifically appointed by the parties, a mediator would normally not act subsequently as an arbitrator regarding the same dispute or relationship. Under other legal systems or specific legislation, however, mediation is seen as an opportunity for the parties to settle amicably their dispute with the assistance of a third party who will have the power, after a predetermined period, to settle the claim as an adjudicatory authority.

(c) Elements of mediation proceedings

30. Mediation proceedings involve a number of elements, which are dealt with by the mediation institution's rules or the parties – either in the contract's mediation clause or at a further stage prior to entering into the proceedings, with the mediator's assistance. Absent specific provisions, default rules may be found in domestic legislation on mediation, or when no such legislation exists, under general contract law.

31. The relevant elements typically include: the scope of the dispute covered by the mediation process; the appointment and role of the mediator(s); the implementation of the proceedings; the exchange of communication between the parties; the adducing of evidence; disclosure and confidentiality issues; the drafting and enforceability of the settlement agreement; the allocation of mediation costs; and the right to initiate arbitral or judicial proceedings. Mediation proceedings may be confidential, with a view to fostering a climate of trust between the parties and confidence in the mediator. As a result, the parties or the mediator should not as a general rule be compelled to give evidence in

judicial proceedings or arbitration regarding information arising out of or in connection with a mediation process.⁵ Clearly, this applies in legal systems where – unless decided by the parties – the same person cannot act as mediator and arbitrator in respect of the same dispute or relationship.

(d) Outcome of mediation proceedings

32. When it exists, the obligation to resort to mediation based on the law or on the contract binds the parties. However, by entering into mediation, the parties do not commit to reach an agreement. General principles – or specific obligations as may be applicable – should govern the parties' conduct, in particular to act in good faith. In certain countries, parties will not be entitled to initiate binding resolution proceedings until the mediation has ended, subject to limitations for the protection of rights. However, no such restriction may apply in other legal systems, and parties may include express wording in the contract to that effect.

33. When mediation does result in an agreement between the parties, it is advisable that they sign a settlement agreement. In all cases, the settlement is contractually binding and parties would be expected to comply voluntarily. However, they may wish to state the binding character of the agreement, and its admissibility as evidence in any action or legal proceeding to enforce its terms. Compliance should also be guaranteed as a matter of law,⁶ and in certain countries, procedures are in place whereby an agreement may, at the parties' request, be confirmed in a judgment, decision or authentic act by a court. In addition, the settlement is, in principle, subject to confidentiality.⁷

C. Arbitration

1. A binding (adjudicatory) dispute resolution

34. Under arbitration, the parties refer the settlement of their dispute to a neutral third party (the arbitrator(s)), whose decision will be binding

⁵ See Art. 10, UNCITRAL Model Law on International Commercial Conciliation.

⁶ See Art. 14, UNCITRAL Model Law on International Commercial Conciliation.

⁷ See Art. 9, UNCITRAL Model Law on International Commercial Conciliation.

and enforceable under the law. Disputes settled under arbitration cannot be subject to a second settlement under judicial procedures.

35. Arbitration is attracting increasing interest in many countries for solving domestic civil and commercial disputes as an alternative to court proceedings because it is seen as combining the advantages of flexible and expeditious proceedings with the effectiveness of judicial outcomes. A number of laws governing agricultural production contracts either encourage or impose upon the parties an obligation to resort to arbitration. Under the law or their contract, parties may and – as seen in the previous section – are sometimes required to seek an amicable settlement before turning to arbitration.

36. Parties have significant autonomy to agree on the arbitration's modalities and to choose their arbitrator, similar to mediation. However, because arbitration is an adjudicatory procedure and is intended to produce the same binding effects as a judicial decision, it is governed by domestic legislation, including many mandatory provisions and default rules. Under domestic arbitration, the arbitrator addresses the dispute based on the applicable law's legal provisions. However, an arbitrator's decision may rest on principles of justice and fairness (so-called "settling *ex aequo et bono*" or as "*amiable compositeur*"), when the parties have so agreed and where the applicable law allows it.

2. Organising arbitration proceedings

(a) Arbitration agreements

37. To choose arbitration, parties should express their intent either in an arbitration clause contained in the agricultural production contract, or under a separate agreement generally concluded after a dispute arises. For the arbitration clause or arbitration agreement to be valid and enforceable, it has to fulfil some requisites that may vary depending on the applicable law. One important requirement, which generally applies, establishes that the arbitration agreement should be in writing or at least evidenced in writing. This formal requirement is intended to ensure that the parties consented to arbitration. It can be found in many domestic laws and international instruments, such as the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)*. The extent to which an arbitration agreement is subject to this condition, and how the condition is to be interpreted, will depend on the applicable law.

38. To obtain an enforceable arbitration clause, parties should also pay special attention to the clause's drafting. For instance, an unclear clause, providing for arbitration and at the same time for the competence of domestic courts, could be declared unenforceable. When drafting the clause, parties are advised to use a language that demonstrates a clear intention to arbitrate and to provide for certain specifications (such as the language or seat of the arbitration). However, the provisions and the degree of detail contained in the clause will depend on whether the parties agree on *ad hoc* or institutional arbitration.

(b) Institutional v. ad hoc arbitration

39. Parties may resort to *ad hoc* proceedings and agree among themselves on the arbitration's main aspects, or they may resort to arbitration administered by an arbitral institution, which generally provides arbitration rules, supervises the process and offers certain assurances regarding its quality and the award's enforceability. If parties agree on institutional arbitration, they should clearly state the institution to which they are submitting the dispute. An error on the designation of the institution chosen may also render the clause unenforceable because the parties' intention may be difficult to ascertain.

40. Specific legislation dealing with agricultural production contracts may provide for a special authority to arbitrate disputes. This will often be the case when the type of contract is regulated as part of public agricultural development programmes (for example as part of land or agrarian reforms involving public financial support or incentives to the producers or investors), or in relation to regulated commodities. Matters that are commonly regulated include setting a maximum time length for the proceedings, determining the possibility and modalities of an appellate review and establishing a timeframe for the appellate judgement to be rendered. To ensure expeditious settlements, the arbitral authority is generally required to render its decision within a given period (for example, thirty days).

(c) Procedural guarantees

41. Because arbitration is an adjudicatory dispute resolution method, particular procedural guarantees should be in place to ensure the proceedings' fairness (*i.e.* that the parties are treated with equality and

provided a full opportunity to present their case).⁸ This is especially true when, as is frequently the case, the arbitration is a single proceeding and not appealable. It must be noted that the arbitration clause or agreement binds only the parties which have expressly agreed to it, which would generally exclude any collective action in support of an individual producer in arbitral proceedings.

42. The use of arbitration proceedings may give rise in certain circumstances to impartiality concerns. As a result, under certain laws the selection of arbitration proceedings is subject to conditions. Some laws prohibit or invalidate mandatory arbitration clauses in agricultural production contracts, in particular in standard contract forms. Others require that the arbitration agreement be signed only after a dispute arises or that the arbitration take place only upon the producer's request. Some also require that any contract requiring arbitration contain a statement allowing the producer, before entering into the contract, to decline to be bound by the arbitration provisions. Parties also have to take into account time limitations to file a claim contained in the applicable law.⁹ If time limits are not respected, the claimant may lose the right to initiate proceedings.

(d) Arbitration and interim relief

43. In order to protect its rights, a party may wish to request interim relief pending the arbitration proceedings. Typically, interim relief takes the form of an order directed at preserving the value of assets subject to contract farming. For example, it may take the form of an order authorising a party to take immediate action for the sale of perishable goods in order to limit losses. Interim relief can be sought by the parties either before domestic courts or an arbitral tribunal once it has been constituted.

44. Most arbitration laws recognise that, when the parties seek interim relief before domestic courts, they are not waiving their agreement to arbitrate.¹⁰ The procedure to follow will be determined by the applicable arbitration law and procedural laws. Recent development in the rules of several major arbitration institutions have also allowed for the use of "emergency arbitrators," in situations where there is a need for urgent

⁸ See Art. 18, UNCITRAL Model Law on International Commercial Arbitration.

⁹ For international commercial contracts, a similar rule is stated in Art. 10.1, UPICC.

¹⁰ See Art. 9, UNCITRAL Model Law on International Commercial Arbitration.

interim relief and the parties cannot wait for the slower process of constituting an arbitral tribunal.

(e) Outcome of arbitration proceedings

45. The enforcement of an arbitral award may usually take place only after a final and binding award deciding all issues in dispute has been issued by the tribunal. Domestically, arbitral awards and judgements can generally be used easily by the winning party to obtain payment. At the international level, and depending on how the issue is regulated in the State where enforcement is sought, the enforcement of an arbitral award under the New York Convention may be easier or subject to less barriers or restrictions than the enforcement of a foreign judgment.

III. Judicial dispute resolution

A. Access to justice

46. If parties have not chosen to pursue arbitration, they may resort to court, which will apply the rules of procedure provided by domestic law. Regulation and the actual operation of public justice, as well as cultural approaches for private parties to resort to court settlement, vary widely between countries. However, every legal system should guarantee free and fair access to justice and enable private parties to settle their dispute before independent judges. Proceedings before the courts are mainly regulated under mandatory law, generally with a high level of formality, justified by the need to ensure procedural guarantees for the litigants.

47. In judicial proceedings, the parties may be required to act through legal representation. Although professional legal representation will, in principle, help parties to present adequately their case and defend their rights, it generally involves significant costs, which depending on the legal system may not be recoverable by the winning party, and if so only after the final judgement. In certain legal systems, legal aid delivered by public services could be available for people unable to afford such costs, in order to ensure the right to a fair trial and the right to counsel. Producer associations and other organisations may play an important role in providing advice and assistance to individual producers in defending their rights through litigation.

48. In many countries, public justice involves complex and lengthy proceedings which may last for several years in civil and commercial

matters. This generally deters parties from relying on the judicial system to obtain redress, particularly for the time sensitive issues that typically arise in agricultural production contracts. Many countries are implementing reforms aimed at increasing justice efficiency, simplifying judicial proceedings, and implementing electronic filing and administration of claims. Some judicial proceedings provide for a preliminary mediation stage seeking fast and amicable settlement. Also, special attention is given in an increasing number of countries to improving the settlement of small claims through flexible and simplified proceedings, in a reasonable time and at an affordable cost.

B. Jurisdiction grounds

1. Domestic contracts

49. Rules relating to jurisdiction – whether a court is competent to hear a dispute – can also be seen as part of procedural guarantees. Depending on the particular legal system and situation, a specific court may be imposed or the possibility of the parties' choice restricted to protect a particular category of party.

50. Jurisdiction may be based on the dispute's subject matter or the parties' capacity. Under a number of legal systems, claims involving agricultural producers would or may fall under the jurisdiction of specialised tribunals or sections in common courts (for example dealing with civil law or agricultural matters). Another ground of jurisdiction relates to territorial criteria. This is the case under certain special laws on agricultural production contracts, which confer jurisdiction upon the courts at the producer's domicile, because the usual rule that gives jurisdiction to the courts at the defendant's domicile may restrict the producer's access to court, given the potentially high costs involved in raising a claim in a distant location.

Based on a similar concern, certain laws set the competent court at the place where the contract – or its main part – is to be performed. When contracts are concluded with members of certain communities, especially indigenous peoples, courts established under customary law may have jurisdiction over some types of disputes. With a view to providing information to the producer, the contract may state the particular court having jurisdiction.

2. *International contracts*

51. When the contract is international in character, issues of jurisdiction and identification of the law applicable to the substance of the dispute are determined by the judge, normally by applying the relevant private international law – or “conflict of law” – rules of its own legal system (see Chapter 1 at paras. 33-40). In international contractual matters, parties enjoy significant autonomy to choose the court to hear the case and the applicable law. However, parties seldom have the power to choose the particular court inside that State. For example, one could probably not choose a small claims court because its jurisdiction is limited by the amount claimed.

IV. Enforcement of settlements or decisions resolving a dispute

52. Efficient enforcement procedures, whether deriving from the contract, or as decided under a dispute resolution mechanism involving a third party, are essential to ensure the effectiveness of legal rules. Not only do they bring redress to the aggrieved party in a particular situation, but they also serve as a deterrent against breach and opportunism in contractual obligations for parties dealing in similar transactions at a global level.

1. *Enforcement by public authorities*

53. As seen above, judicial and arbitral procedures are executory as a matter of public justice. Execution is the phase which takes place after a dispute has been settled under a final decision, *i.e.* when the deadline to file an appeal (if available) has elapsed, and in conformity with the applicable rules. As a matter of principle, the losing party is expected to comply with the final decision voluntarily. When this is not the case, the decision is to be executed by the public authorities.

54. In many countries, execution by public authorities is an additional long phase of the litigation process that proves to be a disadvantage for parties engaged in agricultural production contracts. When enforcement involves the forced payment of money, this may include locating and seizing the defendant’s assets, organising and advertising a public sale of the assets, holding the sale and recovering the value of the claim.

2. Private enforcement mechanisms

55. The lengthy and burdensome (or sometimes even weak or non-existent) public enforcement procedures make private enforcement mechanisms all the more important to foster trust and compliance in agricultural production contracts. Special legislation regulating the field of agricultural production contracts may contain provisions aimed at facilitating enforcement of decisions rendered by the dispute settlement authorities, whatever their nature (public, semi-public or private), set up under such legislation.

56. When parties resort to alternative dispute resolution methods, they are expected to abide by the settlement agreement or the arbitral decision on a voluntary basis. Failure to do so may have reputational consequences affecting the business standing of the non-complying party, or in certain contexts it may entail other types of non-legal sanctions, such as loss of membership. Black listing is one of the most common methods of reputational sanctioning. A company which is black listed is prohibited from engaging in transactions with other members of the organisation, under penalty of serious economic consequences.

57. As illustrated in the Chapter on Remedies for breach, parties themselves may design enforcement mechanisms through the provisions of the contract, including (when authorised by the applicable law) through self-enforcing remedies. However, as said in Chapter 5 (see para. 6), 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).

58. As pointed out throughout the whole Guide, parties to agricultural production contracts would be well advised to consider the importance of drafting their contract in such a way as to foster mutual trust, cooperation and as a result, compliance, through clear and balanced provisions, being aware of the applicable rules and the available dispute resolution mechanisms.

INDEX

(Entries are keyed to paragraphs under each Chapter)

Agricultural production contract

definition, Preface:5, Intro:1, 36
distinct features, Intro:37-46
 contractor's involvement in
 production, Intro:38
distinguished from
 employment, Intro:40, 43-46
 partnership, Intro:41-42
 vertical integration, Intro:39
freedom of contract, 1:1
 content, 2:94
 form, 2:91
 general principle, 1:20
 limitations, 1:1
private law regime, 1:2-4
 mixed nature, 1:6
 prevailing performance, 1:6
 sui generis, 1:6
 typified, 1:6
see Contract, Contract breach, Duration,
Domestic legal sources, Regulatory
environment, Renewal, Termination

Alternative dispute resolution

see Non-judicial dispute resolution

Amicable dispute resolution

see Mediation

Applicable rules

default rules, 1:1
mandatory rules, 1:1
See Domestic legal sources, Inputs,
International element in contract,
Mediation, Quality of product

Arbitration

ad hoc arbitration, 7:34
arbitration agreement, 7:32
 requirements, 7:32
arbitration clause, 7:32
 requirements, 7:33
binding procedure, 7:31

description, 7:9, 7:29
enforcement, 7:39
institutional arbitration, 7:34
 procedural guarantees, 7:13, 7:36
interim relief, 7:38
international contracts, 7:38
limitation under domestic law, 7:37
specific legislation, 7:35
UNCITRAL Model Law on International
Commercial Arbitration, 7:18
see Dispute resolution, Non-judicial
dispute resolution

Breach

see Remedies for breach

Certification

see Production process, Public authorities
and entities, Quality of product

Change of circumstances

applicable rules, 4:33
burden of proof, 4:34-37
definition, 4:8, 4:32
effects on contract, 4:51-57
 judicial adaptation, 4:57
 right or duty to renegotiate, 4:52-55
 good faith, 4:53
force majeure distinguished, 4:10, 4:32
hardship, 4:9
supervening events, 4:20, 4:32
see Force majeure, Good faith,
Supervening events

Conciliation

see Mediation

Contract

content, 2:99-116
 applicable rules, 2:99-100
 identification of parties, 2:99, 2:102
 model forms of contracts, 2:100
required content, 2:99-100
 breach of, 2:117-120

- usual content, 2:101-116
- form, 2:96
 - breach of, 2:117-120
 - written form, 2:117-119
 - applicable rules, 2:117
 - freedom of contract, 2:94, 119
 - language, 2:97-98
 - technical terms, 2:98
 - oral form, 2:92-93
 - specific legislation, 2:96
 - standard form, 2:94-95
 - ex post facto* protection, 2:95
 - gross disparity, 2:95
 - written form, 2:92
 - see Agricultural production contract, Formation, International element in contract, Domestic legal sources, Duration, Good faith, Public authorities and entities, Regulatory environment, Renewal, Termination
- Contract farming**
 - benefits and risks, Intro:15-18
 - access to credit, Intro:26-28
 - economic, social and environmental, Intro:32-34
 - food security, Intro:33
 - risk mitigation, Intro:19-25
 - technology and know-how transfer, Intro:29-31
 - economic definition, Intro:3
 - operations in practice, Intro:6-14
 - commodities, Intro:8-14
 - identity-preserved, Intro:13
 - models, Intro:7
 - public-private partnership, Intro:15, under the guide, Preface:5-7, Intro:5
 - value chain, Preface:4
 - see Agricultural production contract, Parties to the contract, Risks
- Contractor**
 - definition, Intro:36, 2:33, 2:35
 - private corporate structures, 2:35-38
 - commercial entities, 2:37
 - cooperative, 2:38
 - foreign vs. local, 2:36
 - social companies, 2:37
 - public entities, 2:39-42
 - contracting as a direct party, 2:41
 - contracting through a private partner, 2:40
 - see also Parties to the contract, Producer, Public authorities and entities
- Contractor's obligations**
 - interlinked with producer's obligations, 3:3
 - main obligations, 2:105, 3:1, 3:22
 - oversight, monitoring and control in production, 3:1, 3:116-121
 - pay the price, 3:1, 3:142-161
 - producer's remedies for breach, 5:106-107, 5:125-129, 5:133-134, 5:136
 - supply inputs, 2:106-107, 3:1, 3:61-70
 - producer's remedies for breach, 5:108-115, 5:119-122, 5:130, 5:137
 - see also Delivery, Inputs, Insurance, Intellectual property rights, Obligations of the parties, Payment, Price, Producer's obligations, Producer's remedies, Production process
- Contractor's remedies**
 - contributory negligence, 5:39-41, 5:99-104
 - cooperation, 5:99-100
 - duty to mitigate, 5:101-104
 - main remedies, 5:45-98
 - breach of process-related obligations
 - damages, 5:32-36, 5:87-88
 - penalties, fines and blacklists, 5:96-98
 - remedies in kind, 5:10, 5:15-16, 5:48-55
 - termination, 5:12, 5:23-27, 5:82
 - failure to deliver the product
 - damages, 5:32-36, 5:95
 - penalties, fines and blacklists, 5:96-98
 - price reduction, 5:11, 5:21-22, 5:78-80
 - remedies in kind, 5:10, 5:15-16, 5:69-70
 - termination, 5:12, 5:23-27, 5:84-85
 - withholding performance, 5:18-20, 5:75-77
 - product non-conformity
 - damages, 5:32-36, 5:89-94
 - penalties, fines and blacklists, 5:96-98

- price reduction, 5:11, 5:21-22, 5:78-80
 - product withdrawal and recall, 5:71-74
 - remedies in kind, 5:10, 5:15-16, 5:56-67
 - termination, 5:12, 5:23-27, 5:83
 - withholding performance, 5:18-20, 5:75-77
 - see also* Breach of contract, Damages, Contractor's obligations, Cooperation, In-kind remedies, Producer's remedies, Remedies for breach, Termination for breach, Withholding performance
- Cooperation**
- applicable rules, 1:20
 - cooperation duty 1:20
 - and force majeure, 4:49
 - and contract duration, 6:8
 - and remedies, 5:2, 5:39-41,
 - contributory negligence, 5:39-41, 5:99-104, 5:142-145
 - in mitigation, 5:99-100, 5:142
 - in monitoring and control, 3:120
 - in production process, 3:109
 - in renegotiations, 4:55
 - see also* Change of circumstances, Contractor's remedies, Domestic legal sources, Force majeure, Monitoring and control, Production process, Producer's remedies, Remedies for breach
- Damages**
- aim and type
 - burden of proof, 5:34
 - certainty, 5:34
 - consequential damages, 3:56, 5:94, 5:140
 - determining the type and amount, 5:37
 - foreseeability, 5:34
 - full compensation, 5:34
 - reliance damages, 5:36
 - with other remedies, 5:33, 5:90
 - as remedy for contractor, 5:86-95
 - failure to deliver, 5:95
 - process-related, 5:87-88
 - product non-conformity, 5:89
 - penalty clause, 5:93
 - cover purchase, 5:89-91
 - in combination with other remedies, 5:90
 - incidental damages, 5:94
 - reference to market price, 5:93
 - as remedy for producer, 5:135-141
 - delay in payment, 5:136
 - failure to provide conforming inputs, 5:137
 - substitute transaction, 5:137
 - with other remedies, 5:137
 - failure to take delivery, 5:138-140
 - incidental or consequential losses, 5:139
 - unintentionally wrongful rejection, 5:140
 - unsubstantiated or fraudulent claim of non-conformity, 5:140
 - liquidated damages and penalty clauses, 5:141
 - see also* Breach of contract, Delivery, Inputs Production process, Quality of product, Quantity of product, Remedies for breach
- Delivery**
- acceptance, 3:133-141
 - inspection, 3:133-138
 - location, 3:137
 - method, 3:134, 3:137
 - third party monitoring, 3:136, 3:138
 - refusal to take delivery, 3:139-141
 - wrongful rejection, 3:139-141
 - default rules, 3:124-125
 - description, 3:122-123
 - remedies for breach, 5:10-12, 5:15-27, 5:32-36,
 - for contractor, 5:69-70, 5:75-80, 5:84-85, 5:95-98
 - for producer, 5:116-118, 5:131-132, 5:138-140
 - time and place, 3:124, 3:126-132
 - delay, 3:127
 - location, 3:128
 - related obligations, 3:126, 3:129-132
 - see also* Damages, In-kind remedies, Payment, Producer's obligations, Contractor's remedies, Producer's

- remedies, Termination, Withholding performance
- Dispute resolution**
- competition law, 7:2
- factors for choice, 7:8-11, 7:16
 - nature of dispute, 7:10
 - time factor, 7:11
- fairness, 7:13
- fundamental principles, 7:7
- parties' negotiations and cooperation, 7:5
- public or confidential, 7:14
- sequence of methods, 7:6
- see also* Non-judicial dispute resolution, Arbitration, Judicial dispute resolution, Mediation
- Domestic legal sources**
- characterization, 1:5-6, 1:11-15
 - by analogy, 1:6
 - with ownership transfer, 1:13
 - without ownership transfer, 1:14
 - mandatory, 1:15
- customary rules and usages, 1:22-23
- legal pluralism, 1:17
- rules and principles of law, 1:18
 - general contract law, 1:18
 - general principles of law, 1:20
- special legislation
 - applicable to traditional contract forms, 1:11-15
 - for agricultural production contracts, 1:7-10
 - common features, 1:9-10
 - implementation, 1:8
 - nature and scope, 1:7
- standard contract terms, 1:27-28
- soft law, 1:31-32
 - UNIDROIT Principles of International Commercial Contracts (UPICC), 1:32
 - United Nations Convention on Contracts for the International Sale of Goods (CISG), 1:32
- technical standards, 1:29-30
- trade usages and practice, 1:24-25
- unfair terms or practices, 1:19, 1:21
- see also* Applicable rules, Cooperation, Good faith, Intellectual property rights, Public authorities, Regulatory environment
- Duration**
- applicable rules, 6:9-10
- determination, 6:4-5
 - financial obligations, 6:4
 - production cycle, Intro:11, 2:112, 6:4
- short-term vs. long-term, 6:6-8
 - cooperation, 6:8
- Exclusivity**
- and quantity, 3:30
- breach and side selling, 3:21
- business model, 3:19
- definition, 3:18
- risks, 3:20
- see also* Quantity of product, Risks
- Excuses for non-performance**
- see* Change of circumstances, Force majeure, Supervening events
- Force majeure**
- applicable rules, 4:12-14, 4:19, 4:24, 4:26
- burden of proof, 4:34-37
- definition, 4:6-7, 4:21, 4:23
- effects on parties obligations, 4:38-44
 - additional obligations, 4:45-50
 - notice requirement, 4:45-47
 - mitigation requirement, 4:48-50
 - compensation and indemnities, 4:44
 - excuse from non-performance, 4:38-39
 - suspension of performance, 4:40-43
- effects on the contract, 4:51-57
 - right or duty to renegotiate, 4:52-55
 - termination, 4:51
- force majeure clause, 4:19-20
- insurance and risk mitigation schemes, 4:16-18
- kinds of events, 4:22, 4:25-31
 - governmental acts, 4:28
 - natural, 4:25-27
 - other, 4:29-31
- risk allocation, 4:11-14
- title transfer, 4:15
- vs. change of circumstances, 4:5-10

vs. limitation of liability, 4:13
see also Change of circumstances,
 Cooperation duty, Supervening
 events

Formation

acceptance, 2:60, 2:71-73
 additional requirements, 2:72
 registration, 2:87
 review by public entity, 2:87
 definition, 2:71
 replies containing additions, 2:73
 revocation, 2:71
 capacity, 2:74
 consent, 2:75
 access to information, 2:79
 good faith, 2:79
 third party facilitators, 2:77
 applicable rules, 2:75, 2:81
 consent defects, 2:82-83
 avoidance of contract, 2:82-83
 consultation of third parties, 2:78
 enhanced protection to
 producers, 2:81
 informed consent, 2:76-80
 contractor's obligation to
 provide information,
 2:79
 third party facilitators, 2:80
 formation process, 2:60-61
 negotiations, 2:66-67, 2:69
 agreement to agree, 2:68
 facilitators, 2:86
 intermediaries, 2:88
 producer organisations, 2:85
 public entities, 2:87
 offer, 2:57, 2:61-64
 definiteness, 2:63-65
 entire agreement clause, 2:70
 in writing, 2:62
see also Agricultural production
 contract, Contract, Contractor,
 Producer, Public authorities and
 entities

Good faith

general principle of, 1:20
 related to,
 access to information, 2:79
 contract renewal, 6:13, 6:16

determining quantity after
 entering into an agreement, 3:38
 duty to mitigate, 5:103
 enforceability of a contract, 2:68
 formation of contract, 2:61
 mediation, 7:27
 physical inputs, 3:84
 renegotiation, 4:53, 4:55
 title, 3:10

see also Change of circumstances,
 Contract, Formation, Domestic
 legal sources, Inputs, Mediation,
 Obligations of the parties, Risks,
 Product, Quantity of product,
 Remedies for breach, Renewal

Hardship

see Change of circumstances

Indigenous people

see Domestic legal sources,
 Producer, Judicial dispute
 resolution, Mediation

In-kind remedies

aim and types, 5:10-17
 combined with damages, 5:10
 corrective action, 5:10, 5:15
 repair, 5:10, 5:15, 5:16
 replacement, 5:10, 5:15, 5:17
 right to performance, 5:10, 5:15-17
 as remedy for contractor, 5:48-70
 breach of process-related
 obligation, 5:48-49
 right to performance, 5:50
 corrective actions, 5:51-55
 failure to deliver, 5:69-70
 right to performance, 5:69-70
 product non-conformity, 5:56-57
 applicable rules, 5:61
 corrective actions, 5:62-65
 repair, 5:66
 replacement, 5:67-68
 structuring remedies, 5:59
 as remedy for producer, 5:106-118
 delay in price payment,
 5:106-107
 failure to provide (conforming)
 inputs, 5:108-115
 time and detection of
 contractor's breach, 5:109-111
 multi-party contract, 5:115

third-party beneficiary,
5:113-114
failure to take delivery, 5:116-118
resale of goods, 5:118
see also Breach of contract,
Delivery, Inputs, Quality of
product, Quantity of product,
Remedies for breach

Inputs
definition, 3:61
essential term, 2:107
general obligations, 3:62-70
contractor supplied inputs,
3:63-68
benefits, 3:63
difficulties, 3:68
producer's related obligations,
3:64-68
price and payment, 3:65-67
producer supplied inputs, 3:69
third party supplied inputs, 3:70
remedies for breach, 5:10-20,
5:23-27, 5:33-37
for contractor, 5:48-55
for producer, 5:108-115,
5:119-122, 5:130, 5:137
specific obligations, 3:71-92
ancillary obligations, 3:75
financing, Intro:10, 3:85-89
applicable rules, 3:88
interests, 3:87
risks, 3:89
land and fixed assets, 3:71-75
investments and contract
duration, 3:74
lease and contract duration, 3:72
physical inputs, 3:76-84
applicable rules, 3:77
safety requirements, 3:80
delivery, 3:82-84
supply, 3:76-77
default rules, 3:77
tortious liability, 3:81
usage, 3:79
services, 3:90-92
technical assistance, 3:91-92
allocation of risks, 3:92
standards of performance, 3:92
see also Contractor's obligations,
Contractor's remedies, Duration,

Good faith, Payment, Parties to
the contract, Price, Producer's
obligations, Producer's remedies,
Regulatory environment, Risks

Insurance

affordable modes of insurance, 3:166
insurance clause, 3:163-164
national insurance schemes, 4:17
obligation, 3:163
risk mitigation, 4:16-17
transfer of benefits, 3:165
see also Risks

Intellectual property rights

description, 3:93
technology transfer, Intro:30
duties after contract termination, 3:101
information asymmetry, 3:102
licensing, 3:96-98
licensing agreement, 3:96
purchase proprietary seeds and traits,
3:98
patent, 3:94
plant variety rights, 3:94
producer's special obligations, 3:97
registered trademark, 3:95
third parties holding IP rights, 3:99
applicable rules, 3:93
trade secret, 3:95
see also Regulatory environment

International element in contract

contractual obligations, 1:34-38
applicable law, 1:34-35, 2:36-37, 7:44
arbitration, 1:38
UNIDROIT Principles of
International Commercial
Contracts (UPICC), 1:38
United Nations Convention on
Contracts for the International
Sale of Goods (CISG), 1:37
international arbitration, 7:39
international contractor, 2:36
international safety and quality
standards, 2:49, 3:39, 3:51
non-contractual obligations, 1:39-40
applicable law, 1:40
product liability, 1:39
see also Contractor, Non-judicial
dispute resolution, Judicial
dispute resolution, Parties to the

- contract, Quality of product, Regulatory environment
- Judicial dispute resolution**
- description, 7:9
- factors affecting the application, 7:10-11
 - efficiency, 7:43
- international contracts, 7:44
- procedural guarantees, 7:40-41
 - access to justice, 7:40
 - forum's jurisdiction, 7:41
 - indigenous people, 7:41
 - legal representation, 7:42
- see also* Dispute resolution
- Legal Guide on Contract Farming**
- addressees, Preface:2-3
- approach, Preface:4-7
 - bilateral relationship, Preface:5
- reference to domestic and international rules Preface: 6-7
 - how to use, Preface:9
- overview and purpose, Preface:1
- see also* Contract farming
- Mediation**
- ad hoc* mediation, 7:25
- advantages, 7:21
- applicable rules, 7:22, 7:26-27
 - specific legislation, 7:22
 - obligation to resort to mediation, 7:27
 - default rules, 7:26
- definition, 7:9, 7:20
- institutional mediation, 7:24-25
- mediation clause, 7:22-23
- mediators
 - independence and impartiality, 7:13
 - special mediators, 7:25
 - social network mediators, 7:25
- relevant elements, 7:26
- settlement agreement, 7:28
- UNCITRAL model law on International Commercial Conciliation, 7:18
- with other dispute resolution methods, 7:20
- see also* Non-judicial dispute resolution
- Non-binding alternative dispute resolution**
- see* Mediation
- Non-judicial dispute resolution**
- ad hoc* procedure, 7:17
- domestic legislation, 7:18
 - enforcement, 7:45-46
- factors affecting the application, 7:10-11, 7:16
 - nature of the dispute, 7:10
 - time factor, 7:11
- institutional procedure, 7:17
- interim relief, 7:12
- parties' mutual consent, 7:15
- United Nations Commission on International Trade Law (UNCITRAL), 7:18
- see also* Arbitration, Dispute resolution, Judicial dispute resolution, Mediation
- Obligations of the parties**
- additional obligations, 3:162
 - community interests, 3: 170
 - insurance, 3:163-166
 - record keeping and information management, 3:167-169
 - confidentiality clause, 3:169,6:39
- extra-contractual obligations, 3:5
- interlinked nature of, 3:3
- post-contractual obligations, 6:39
- product-related, 3:2, 3:23, 5:7, 5:44-45
 - remedies for breach, 5:10-12, 5:15-27, 5:32-36, 5:56-67, 5:71-80, 5:83, 5:89-94, 5:96-98
- process-related, 3:2, 3:60, 5:7, 4:44-45
 - remedies for breach, 5:10, 5:12, 5:15-16, 5:23-27, 5:32-36, 5:48-55, 5:82, 5:87-8 8, 5:96-98, 5:108-115
- transfer of, 3:171
 - transfer of rights, 3:171
- see also* Contractor's obligations, Contractor's remedies , Delivery, Exclusivity, Inputs, Insurance, Intellectual property rights, Payment, Price, Producer's obligations, Producer's remedies, Quality of product, Quantity of product, Risks
- Parties to the contract**
- contractor, 2:33
- producer, 2:5
- supply chain participants, 2:44
 - description, 2:44
 - linkages between participants, 2:45-48
 - types of participants, 2:49-59

- extension service providers, 2:56
- financing institutions, 2:52
- input suppliers, 2:50
- insurers, 2:53
- service providers, 2:51
- verification entities, 2:54-55
- other third parties, 2:57-58
 - landowner, 2:57
 - creditors, 2:58
 - third parties' rights, 2:59
- see also* Contractor, Producer

Payment

- for product, 3:157
 - time and method of payment, 3:157-161
 - currency, 3:161
 - delayed payment, 3:158-159
 - risks, 3:158
 - mitigation, 3:158
 - interests, 3:159
- for inputs, 3:65-67
- remedies for breach, 5:10, 5:12, 5:15-20, 5:23-27, 5:32-36
 - for producer, 5:106-107, 5:119-122, 5:136, 5:133-134
- see also* Delivery, Inputs, Price, Producer's remedies, Remedies for breach

Price

- description, 3:142
- fixed price and scales combined, 3:147, 3:153
- fixed price, 3:148-150
 - advantages vs. disadvantages, 3:150
 - factors, 3:149
- price determination, 3:143-146
 - duress, 3:146
 - essential term, 3:143
 - price clause, 3:144
 - clear and transparent, 3:144
 - unfair price terms, 3:145
 - set by government regulation, 3:147
- revision mechanism, 3:156
- scales, 3:138, 3:151-156
 - advantages vs. disadvantages, 3:153
 - based on services, 3:152
 - third party intervention, 3:154
- see also* Inputs, Payment

Producer

- distinctive features, 2:6-8
- forms, 2:12
- individual, 2:13-19
 - corporate structures, 2:18-19
 - natural persons and partnerships, 2:13-17
- producer organisations, 2:20-21
 - cooperatives, 2:23-32
 - formal vs. informal, 2:22, 2:25
 - freedom of association, 2:24
 - non-profit entities, 2:26-27
 - role, 2:24, 2:85
 - smallholder producers, 2:22
 - traditional communities, 2:23
- legal status, 2:9-11
 - civil vs. commercial, 2:10
 - merchant, 2:11
- see also* Contract, Contractor, Formation, Producer's obligations

Producer organisation

see Producer

Producer's obligations

- interlinked with contractor's obligations, 3:3
- main obligations, 2:105, 3:1, 3:23
- production, 3:1, 3:60-121
 - contractor's remedies for breach, 5:48-55, 5:82, 5:87-88, 5:96-98
 - delivery, 3:1, 3:122-141
 - contractor's remedies for breach, 5:69-70, 5:75-80, 5:84-85, 5:95-98
 - related obligations, 3:1
- see also* Contractor's obligations, Delivery, Inputs, Insurance, Intellectual property rights, Obligations of the parties, Payment, Price, Production process

Producer's remedies

- contributory negligence, 5:39-40, 5:142-145
 - cooperation, 5:142
 - duty to mitigate, 5:143
- main remedies, 5:105-141
 - failure or delay in payment
 - damages, 5:32-36, 5:136
 - right to performance, 5:10, 5:15-16, 5:106-107

- termination, 5:12, 5:23-27, 5:133-134
- withholding performance, 5:18-20, 5:119-122
- failure to provide (conforming) inputs
 - damages, 5:32-36, 5:137
 - right to performance, 5:10, 5:15-16, 5:108-115
 - termination, 5:12, 5:23-27, 5:130
 - withholding performance, 5:18-20, 5:119-122
- failure to take delivery of
 - conforming goods damages, 5:32-36, 5:138
 - right to performance, 5:10, 5:15-16, 5:116-118
 - termination, 5:12, 5:23-27, 5:131-132
- sphere of control, 5:46
- see also* Breach of contract, Contractor's remedies, Cooperation, Damages, Delivery, In-kind remedies, Inputs, Payment, Remedies for breach, Termination for breach, Withholding performance
- Product**
- see* Quality of product, Quantity of product
- Production process**
- applicable rules
 - certification, 3:104-106
 - certifiers, 3:106
 - description, 3:104
 - legal effect, 3:106
 - producers as initiators, 3:105
 - express vs. implied obligation, 3:108
 - private standards, 3:104-106
 - traceability, Intro:13, 3:113
- description, 3:60, 3:100
- monitoring and control by contractor, 3:116-121
 - access to production site, 3:116-118
 - cooperation, 3:120
 - key operations, 3:119
- remedies for breach, 5:10, 5:12, 5:15-16, 5:23-27, 5:32-36, 5:48-55, 5:82, 5:87-88, 5:96-98, 5:108-115
- specified production methods, 3:107-115
- cooperation, 3:109
- harvesting, 3:111
- industry codes of conduct, 3:115
- labour and hygiene, 3:114
- livestock and poultry, 3:112
- obligation to comply with
 - instructions, 3:107, 3:109-114
- planting or sowing, 3:110
- use of fertilizers, 3:110
- weed and pest control, 3:110
- see also* Contractor's obligations, Contractor's remedies, Cooperation, Delivery, Inputs, Intellectual property rights, Obligations of the parties, Producer's obligations, Producer's remedies, Quality of product, Quantity of product
- Public authorities and entities**
- enabling policies, Intro:15, Intro:17, Intro:27, 1:56, 2:13, 2:21, 2:52, 3:158
- in dispute resolution
 - mandatory jurisdiction of public entities, 7:10
 - promoting alternative dispute resolution institutions, 7:17, 7:24
- in excuses for non-performance
 - supervening events, 4:28
- in legal framework
 - human rights, Intro:34, 1:59-60
 - standard contracts, 1:27
- in parties' obligations
 - certification standards, 3:49, 3:80
 - price mechanisms, 3:147
- in parties, formation and form
 - as contractor, 2:41
 - as facilitators, 2:42
 - in contract negotiations, 2:87
 - oversee conclusion, 2:87
 - registration, 2:87
 - review compliance, 2:87
- extension services, 2:56
- insurance, 2:53
- procurement procedure, 2:40-41
- third party verification, 2:54
- in remedies
 - product withdrawal, 5:73
- see also* Contractor, Dispute resolution, Formation, Insurance, Non-judicial dispute resolution, Price, Public

- authorities and entities, Regulatory environment, Remedies for breach
- Quality of product**
- and quantity, 3:23
- determining quality, 3:42-44
- express vs. implied, 3:40
- link with certification requirements, 3:58-59
- process quality, 3:41
- product quality, 3:41
- product safety, 3:55-57
 - packaging and labelling, 3:57
- remedies for breach, 5:10-12, 5:15-27, 5:32-36, 5:56-67, 5:71-80, 5:83, 5:89-94, 5:96-98
- standards, 3:45-54
 - clause, 3:53
 - applicable rules, 3:49-52
 - external standards, 3:49
 - Good Agricultural Practices, 3:49
 - limits of liability, 3:54
 - consequential damages, 3:54
- traceability, Intro:13, 3:113
- see also* Applicable rules, Damages, Production process, Quality of product, Regulatory environment
- Quantity of product**
- and exclusivity, 3:30
- and quality, 3:23
- part of production, 3:32-39
 - advantage, 3:32
 - determining quantity after entering into the agreement, 3:36-38
 - excess production, 3:33
 - minimum quantity, 3:35
 - quota, 3:35
- remedies for breach, 5:10-12, 5:15-27, 5:32-36, 5:56-67, 5:71-80, 5:83, 5:89-94, 5:96-98
- whole production, 3:25-31
 - exceptions, 3:31
 - implied exclusivity, 3:27
 - side selling, 3:28-30
- see also* Exclusivity, Force majeure, Good faith, Quality of product
- Regulatory environment**
- access to natural resources, 1:41, 1:62-63
 - free, prior, and informed consent, 1:62
- agricultural finance and support, 1:55
- agri-food trade
 - international trade law, 1:43-44
 - protection of health and environment, 1:41
 - animal health and production, 1:46
 - food safety, 1:45
 - plant protection standards, 1:47
- biosafety, 1:51
- competition law, 1:56-57
 - unfair practices, 1:56
 - unfair terms, 1:56-57
- human rights, Intro:34, 1:41, 1:58
 - principles, 1:59
 - right to food, 1:59
 - vulnerable parties, 1:59
- labour law, 1:41, 1:60-61
 - international labour standards, Intro:34
- other agricultural inputs, 1:54
- plant variety protection, 1:52
- producer's right to genetic material, 1:53
- seeds, 1:50
- see also* Formation, Inputs, Intellectual property rights, International element in contract, Public authorities and entities, Production process
- Remedies for breach**
- applicable rules, 5:3-6, 5:48
- breach
 - anticipatory, 5:18
 - definition, 5:1-2
 - fundamental, 5:3
 - product-related obligation, 5:7-8
 - process-related obligation, 5:7-8
- contributory negligence, 5:39-41, 5:99-104, 5:142-146
- definition, 5:1
 - compensatory, 5:105
 - cooperative, 5:105
 - enforcement mechanisms, 5:4
 - judicial vs. non-judicial, 5:4
 - self-enforcing, 5:4
 - vs. excused non-performance, 5:1-2
- in-kind, 5:10, 5:15-17
- liquidated damages clause, 5:36-37, 5:86, 5:141
- monetary, 5:11
 - damages, 5:32-36
 - interest and late payment, 5:38
 - price reduction, 5:11, 5:21-22

penalty clause, 5:141
renegotiation, 5:44
restitution, 5:28-32
right to cure, 5:22, 5:42-43
termination, 5:12, 5:23-27
withholding performance, 5:18-20
see also Breach of contract, Contractor's remedies, Cooperation, Damages, In-kind remedies, Producer's remedies, Production process, Quality of product, Quantity of product, Termination for breach, Withholding performance

Renewal

applicable rules, 6:18
at the option of one party, 6:19
 applicable rules, 6:19
by express agreement, 6:12-13
short term vs. long term, 6:16
tacit or automatic, 6:14-18
 good faith, 6:16
 notice, 6:16
 prohibition of inconsistent behaviour, 6:16
see also Duration, Termination

Right to performance

see In-kind remedies

Risks

risk allocation, Intro:24-25, 3:6-17
 commercial risk, 3:6, 3:13-17
 price fluctuation, 3:16
 price mechanism, 3:17
 production risk, 3:6-13
 default risk allocation, 3:7
 risk shifting, 3:12
 title, 3:8-12
 transferring, 3:8, 3:10, 4:15
risk mitigation, Intro:19-25
 exclusivity, Intro:20
 revision clause, 4:18, 4:54
 price, 4:18
see also Contract farming, Exclusivity, Force majeure, Inputs, Insurance, Price

Specific performance

see Right to performance

Smallholder /small scale producer

see Producer

Supervening events

Force majeure
 kinds, 4:2-4
 natural events, 4:2
 governmental acts, 4:3
 other, 4:3
change of circumstances
 supervening events, 4:20, 4:32
special relevance, 4:4
see also Change of circumstances, Force majeure

Termination

definition, 6:20
 force majeure and termination, 6:20
effects and consequences, 6:38-39
 post-contractual obligations, 6:39
grounds, 6:25-37
 automatic, 6:26
 by either party, 6:29-31
 consensual, 6:27
 loss of trust, 6:36-37
 unilateral, 6:16, 6:32-35
 applicable rules, 6:34-35
notice, 6:17, 6:22-24, 6:29
termination clause, 2:114, 6:21
see also Force majeure, Obligations of the parties, Termination for breach

Termination for breach

as a remedy for contractor, 5:81-85
 breach of process-related obligations, 5:82
 failure to deliver, 5:84-85
 product non-conformity, 5:83
as a remedy for producer, 5:123-124
 failure to pay, 4:125-129
 anticipatory breach, 5:127
 failure to provide (conforming) inputs, 5:130
 failure to purchase the whole production, 5:133-134
 failure to take delivery, 5:131-132
 selection, 5:123
 termination clause, 5:124
effects, 5:12, 5:26-27
fundamental breach, 5:12, 5:23
right to cure, 5:42
procedure, 5:25
 grace period, 5:25
 notice requirement, 5:25

total or partial termination, 5:27
see also Breach of contract, Contractor's obligations, Producer's obligations, Remedies for breach, Termination

Traditional community

see Domestic legal sources,
Producer, Mediation

**UNIDROIT Principles of
International Commercial Contracts
(UPICC)**

see Domestic legal sources,
International element in contract

**United Nations Convention on
Contracts for the International Sale
of Goods (CISG)**

see Domestic legal sources,
International element in contract

Withholding performance

as a remedy for contractor, 5:75-77
 refusing delivery, 5:75
 withholding other types of
 performance, 5:77
 withholding payment, 5:75-76
as a remedy for producer, 5:119-121
 advance contractual payments, 5:121
 effectiveness of, 5:120
 limitations of, 5:120, 5:121
description, 5:19
use of, 5:18
see also Contractor's obligations,
Obligations of the parties,
Producer's obligations, Remedies
for breach